

Western Grain Transportation

Report on consultations and recommendations

J. C. Gilson

Canada



WESTERN GRAIN TRANSPORTATION OFFICE

5th Floor, Kensington Building
275 Portage Avenue
Winnipeg, Manitoba R3B 2B3

June 15, 1982

The Honourable Jean-Luc Pepin
Minister of Transport
House of Commons
Ottawa, Ontario

My Dear Minister,

I am pleased to submit my report on the consultations with western farm organizations and the two national railways together with my recommendations and observations.

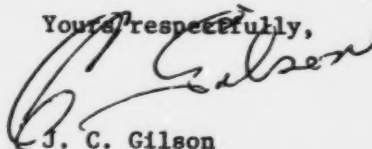
I wish to take this opportunity to express my appreciation for the invaluable assistance which I received from officials and staff of your Department and other Departments of the Federal Government, and for the frank and constructive views which I received from all sectors of the grain handling and transportation system in western Canada. Acknowledgement must be made of the very special contributions by the representatives of the organizations invited to participate in the consultation process; their help and co-operation made an extremely complex and difficult task both agreeable and possible.

While this report discusses a number of serious problems and concerns associated with the grain handling and transportation system in western Canada, those problems should not be permitted to overshadow the fundamental strengths and the very real opportunities for growth and development in this important sector of the Canadian economy.

It is my sincere hope that the results and recommendations contained in my report will help you and others in the grain transportation system to build on these strengths and opportunities.

I will, of course, be available to discuss the report with you at your convenience.

Yours respectfully,



J. C. Gilson

© Minister of Supply and Services Canada 1982

Available in Canada through

Authorized Bookstore Agents
and other bookstores

or by mail from

Canadian Government Publishing Centre
Supply and Services Canada
Ottawa, Canada, K1A 0S9

Catalogue No. T 22-58/1982E
ISBN 0-660-11180-2

Canada: \$6.00
Other countries: \$7.20

Price subject to change without notice

TABLE OF CONTENTS

List of Tables	
List of Figures	
Acknowledgements	
Foreword	

I. FRAMEWORK FOR THE CONSULTATION PROCESS	I-1
(1) Federal Government Policy Statement	I-1
(2) Appointment of the Federal Representative	I-4
(3) Organizations Included in the Consultation Process	I-5
II. WESTERN GRAIN TRANSPORTATION - AN OVERVIEW	II-1
(1) Prairie Agriculture in the Canadian Economy	II-1
(2) The Statutory Rate Problem	II-2
(3) The Origins of the Crowsnest Pass Agreement and Statutory Rates	II-3
(4) The Transportation Problem Emerges	II-5
(5) The Transportation Problem Becomes Critical	II-6
(6) The Need for Action	II-10
III. THE CONSULTATION PROCESS	III-1
(1) Establishment of Office and Secretariat	III-1
(2) Schedule for the Consultations and Report Preparation	III-1
(3) Preparation of Technical Working Papers	III-3
(4) First General Meeting of Organizations	III-3
(5) Informal Consultations	III-4
(6) Formal Consultations	III-5
IV. THE BACKGROUND ISSUES	IV-1
(1) Transportation and Agricultural Development	IV-1
a) Potential for Grains and Oilseeds	IV-1
b) Potential for Special Crops	IV-1
c) Potential for Livestock	IV-2
d) Potential for Agricultural Processing	IV-3
(2) Distributional Impact of Statutory Rate Structure on Agricultural Development	IV-4
a) General Distributional Impacts	IV-4
b) The "Crow Benefit"	IV-7
c) Views on the "Crow Benefit"	IV-8
d) Agricultural Adjustment Benefits	IV-10

(3) Payment of the Railway Revenue Shortfall	IV-12
a) The Railway Revenue Shortfall	IV-12
b) Alternative Methods of Disbursement of the Railway Revenue Shortfall	IV-12
c) Administrative Considerations	IV-15
i) Pay the Railways	IV-15
ii) Pay the Producers	IV-15
1. Direct Payment Option	IV-15
2. Producer Freight Credit Option	IV-16
(4) Railway Costing	IV-18
a) Railway Costs - Definitions and Significance to the Process	IV-18
b) Railway Cost Categories	IV-18
c) Relevance of the Cost Categories to Railway Compensation for the Transportation of Statutory Grain	IV-19
d) Development of the Base Year Railway Compensation Level	IV-20
e) Variable Costs - 1980	IV-22
i) Cost of Capital	IV-22
ii) Branch Line Rehabilitation Assets	IV-22
f) Cost Increases to 1981-82	IV-24
g) Contribution to Constant Costs	IV-24
i) The Shippers' Position	IV-24
ii) The Railways' Position	IV-26
h) Resolution	IV-26
(5) System Efficiency	IV-27
a) Changes to Physical Facilities	IV-28
b) Changes to Operating Practices	IV-29
c) Improved Information and Planning	IV-29
d) Summary	IV-30
(6) Sharing of Future Cost Increases	IV-31
V. THE COMPREHENSIVE APPROACH TO THE SOLUTION	V-1
(1) The Search for Common Ground	V-1
(2) The Comprehensive Approach	V-4
(3) The Cost of the Solution	V-6
a) Volume of Grain Shipments	V-6
b) Railway Revenue Shortfall	V-6
c) Federal Government Capital Program in Grain Transportation	V-11
d) Sharing of Future Cost Increases	V-11
i) Volume Changes	V-15
ii) Productivity and Efficiency Gains	V-15
iii) Cost Increases	V-16
iv) Agricultural Adjustment Shortfall	V-17
v) Phasing	V-18
vi) The Cost	V-18
(4) A New Freight Rate Structure for Grain	V-26

(5) Performance and Service Guarantees	V-28
a) Introduction	V-28
b) Need for a Co-ordinating Structure	V-28
c) Structure and Function of a Central Co-ordinating Agency	V-29
i) Senior Grain Transportation Committee	V-29
ii) Duties, Powers and Responsibilities of the Central Co-ordinating Agency	V-30
iii) Operating Committee	V-32
d) Complementary Role of the Canadian Transport Commission	V-33
e) Possible Approach to the Negotiation of a Tonnage Guarantee	V-33
(6) Legislative Issues and Implementation	V-35
(7) The Review Process	V-38
 VI. SUMMARY OF RECOMMENDATIONS AND GENERAL OBSERVATIONS	 VI-1
(1) General Observations	VI-1
(2) Summary of Recommendations	VI-5
a) Principle 1	VI-5
b) Principle 2 (a)	VI-6
c) Principles 2 (b) and 3	VI-7
d) Principle 4 (a)	VI-8
e) Principle 4 (c)	VI-8
f) Principles 4 (b) and 4 (d)	VI-8
g) Principle 5	VI-9
h) Principle 6	VI-9
i) Principle 7	VI-10
j) Major Subjects for Consultation	VI-10
k) Recommendations for Further Review	VI-11

Appendix A: GLOSSARY OF TERMS

Appendix B: ORGANIZATIONAL CHART AND PARTICIPANTS IN CONSULTATION PROCESS

LIST OF TABLES

IV-1	Grains, Oilseeds and Products that Qualify for Statutory Freight Rates from Western Canada	IV-6
IV-2	Comparison of Variable Cost Proposals - 1980	IV-23
IV-3	Comparison of Railway Cost Increases, Cost Factors and Weighting of Factors (1980 to 1981-82)	IV-25
IV-4	Wheat Prices and Freight Rates	IV-35
IV-5	Actual and Deflated Average Price Received for Wheat, Prairie Provinces (1930-31 to 1980-81)	IV-36
IV-6	Total Railway Revenue Requirements with Inflation Rate at varying Levels	IV-40
IV-7	Shares of Total Railway Revenue Requirements Assuming an 8% Inflation Rate and Varying Contributions by Producers	IV-42
IV-8	Example of Calculated Freight Rates as a Percent of Wheat Prices	IV-43
V-1	Estimated Shipment Volumes for the 1981-82 Crop Year	V-8
V-2	Railway Revenue Shortfall (1980 and 1981-82)	V-9
V-3	Cost Implications of Productivity Gains Resulting from Abandonment of Unprotected Branch Lines and Replacement of box cars with hopper cars	V-12
V-4	Adjusting 1981-82 Cost Base for Productivity Increases Due to Abandonment of 175.6 miles of Branch Lines between 1980 and 1981-82 and the Replacement of box cars with hopper cars during the same period	V-13
V-5	Federal Government Capital Program Relating to Grain Transportation	V-14
V-6A	Cost Implications of Option Assuming Cost Increases of 8% for 1982-83 to 1985-86 and 6% Thereafter, Shippers sharing up to 3% of Cost Increases Starting in 1983-84	V-19
V-6B	Cost Implications of Option Assuming cost Increases of 8% for 1982-83 to 1985-86, and 6% Thereafter, Shippers Sharing up to 3% of Cost Increases for the Period of 1983-84 to 1985-86, and Paying the first 3% of Cost Increases after 1985-86 and Sharing the Next 3% for total of 4½ percent.	V-20

V-6C	Cost Implications of Option Assuming Cost Increases of 8% for 1982-83 to 1985-86 and 7% Thereafter, Shippers Sharing up to 3% of Cost Increases for the Period 1983-84 to 1985-86. Paying the first 3% of Cost Increases after 1985-86 and Sharing the Next 4% for a total of 5 percent.	V-21
V-6D	Cost Implications of Option Assuming Cost Increases of 8% for 1982-83 to 1985-86 and 6% Thereafter, Shippers Sharing up to 3% of Cost Increase during 1983-84 to 1985-86; Starting in 1986-87 Shippers pay first 3% and Increase by $\frac{1}{2}$ % year until 1992-93 When Shippers are paying all cost Increases (6%)	V-22
V-6E	Cost Implications of Option Assuming Cost Increases of 10% for 1982-83 and Thereafter, Shippers Sharing up to 3% of Cost Increases starting in 1983-84	V-23
V-6F	Cost Implications of Option Assuming Cost Increases of 10% for 1982-83 and Thereafter, Shippers Sharing up to 3% of Cost Increase during 1983-84 to 1985-86; Starting in 1986-87 Shippers Pay First 3% and Increase by 1% Each year Until 1993-94 When Shippers are Paying all Cost Increases (10%)	V-24
V-7	Calculation of Agricultural Adjustment Shortfall As Proposed by the Shippers	V-25

LIST OF FIGURES

IV-1	Total Railway Revenue Requirements with Inflation Rate at Varying Levels	IV-41
IV-2	Example of Calculated Freight Rates as a Percentage of Wheat Prices	IV-44





PARTICIPANTS IN THE CONSULTATION PROCESS

FRONT ROW: Ted Turner, President Saskatchewan Wheat Pool;
Wallace Fraser, President Manitoba Pool Elevators;
Dr. J.C. Gilson, Federal Representative;
Ivan MacMillan, Chairman, Prairie Farm Commodity Coalition;

STANDING: R.S. Allison, Executive Vice President CP Rail;
Chris Mills, Representative PFCC;
Gordon Blanchard, Vice President Unifarm;
Jack Smythe, Representative Canola Crushers of Western Canada;
Howard Falkenberg, President Unifarm;
Lorne Parker, President Manitoba Farm Bureau;
Bud Morken, Vice President United Grain Growers;
Allan Macpherson, President Alberta Wheat Pool;
Gary Carlson, Executive Secretary for Sask. Federation of Agriculture;
Ken Stickland, Representative PFCC;
Ron Lawless, President CN Rail;
Stan Price, Representative PFCC.

Acknowledgements

No project as large and complex as the one in which we were engaged during the past 126 days would have been completed without the whole hearted co-operation and assistance of a large number of persons and organizations. It would be impossible to make an exhaustive list of all those who contributed to the final results of the consultation process. To all those who assisted me in so many ways, I express my sincere thanks and appreciation.

There are some, however, whose specific contributions I wish to acknowledge. I owe a particular debt of gratitude to E. W. Tyrchniewicz and D. A. Leitch whose sound professional advice, hard work and many creative ideas are reflected throughout the final report. G. McLaughlin, R. Wansbutter, M. Duncan, L. Robertson, D. Suggitt and S. Ursan-Winter, responded cheerfully and without question, to the pressure and unyielding deadlines associated with their work.

I must also acknowledge A. Kroeger, N. Mulder, W. Miner, M. Farquhar, H. Migie, J. Heads, M. Tosh, and many others from Transport Canada, Agriculture Canada, and the Canadian Transport Commission for their continuing help and advice and their willingness to prepare a series of technical background papers under severe time constraints for the participants in the formal consultation process.

Still others must be recognized for the many and important ways in which they assisted with the project: C. Snavely, A. Wood, N. Irwin, D. Kraft, A. Wilson, B. Mertick, D. Beaulieu, K. Thompson and the Prairie provinces crop insurance officials whose thoroughly professional contributions to the work are deeply appreciated.

Finally, I wish to express my gratitude to the representatives of the organizations and their hard working advisors who participated in the many hectic and productive meetings in Winnipeg. These people were not intimidated with the preciously short time available, nor the complex and challenging task imposed on them by the consultation process. The fact that the process succeeded was due, in no small measure, to the dedication and commitment of this able, experienced and remarkable group of people.

Perhaps, the true reward for all those who gave so generously of their time and talent to the consultation process, will come with the development of a lasting long run comprehensive policy for grain transportation in western Canada.



FOREWORD

Agriculture, the reason for the settlement and first development of the west, continues to be the backbone of the economies of the three Prairie provinces. It was the land and the prospect of a good life, earning one's living from the land, that attracted those first settlers from eastern Canada, the United States, and overseas. The settlers came and established their communities and farms. They came by railway; on Canada's first transcontinental railway linking west and east. It was a railway being built at great cost to private investors and the federal treasury; but was necessary in the view of the governments of the day to build a nation where none existed, and to tie new communities in the west to older established communities in the east by providing the vital economic link between east and west.

From those early days in the 1880's and 1890's the farmers of western Canada and the railways were linked in a partnership. That partnership became a vital part of the social and community fabric of western Canada. Western Canadians, particularly those in smaller communities were totally dependent upon the railways for transportation and communication.

Even with changes in communities, new forms of transportation, and the changing economic and social structure of the west, the relationship between farmers and the railways has remained strong. Railway transportation continues to be, by and large, the only way of moving western grain off the Prairies to export positions or domestic users in eastern Canada.

The farmers of western Canada have had the protection of a statutory rate for transporting grain since late in the 19th century. That the rate has benefitted western farmers in protecting their incomes is accepted. Whether that same statutory rate may have hindered economic development and diversification in western Canada is now being debated. With grain prices dictated by international market forces, with changing and variable costs for other inputs such as fuel and fertilizer, the freight rate for grain was the one known and constant factor in the account books of western farmers.

Rapidly changing economic conditions on a national and global scale, energy crises, and the world food crisis, have of course affected the Prairie farmer. Particularly in recent years, he has seen his income fluctuate with world prices for grain, while watching those energy and fertilizer prices rise because of other actions in the world and national market place.

Similarly, the railways of western Canada were confronted with rising costs, increasing faster than the limited revenue from hauling grain at statutory rates. As a result, the established branch line rail network was not being maintained at a level to provide what many farmers felt was adequate service. In response to the growing Prairie rail transportation problem the Federal Government began in 1971 to provide a large amount of funds for branch line subsidies, hopper car purchases, branch line rehabilitation and other related programs. At best, it can be said that those were interim funds for various programs to ease immediate difficulties, but not to provide a lasting cure for the basic problems besetting the grain transportation system.

When serious discussions began as to whether or not the statutory rate for grain should be revised the question was asked: Can western farmers afford to pay more? Equally important was the question: Can western agriculture survive with a deteriorating rail system?

The dilemma confronting the railways and farmers of western Canada is quite simply: "Do we want an on-going, viable rail transportation system for grain, at what cost, and who bears the cost?"

The challenge is to develop a comprehensive framework within which the railways, the users and government itself can share equitably in the task of maintaining a western grain transportation network and expanding western rail capacity to meet the heavy demands that are expected in the years ahead from a growing western economy.

I. FRAMEWORK FOR THE CONSULTATION PROCESS

This chapter is intended to provide an understanding of the Federal Government's Policy Statement, its principles, and the major subjects identified by the Federal Government for discussion during the consultation process.

(1) Federal Government Policy Statement

On February 8, 1982, the Honourable Jean-Luc Pepin, Minister of Transport, issued a statement of Federal Government policy on western rail transportation for assuring adequate rail capacity to meet the current state of the rail system and how future needs might be met.

Statutory grain rates now cover about 20% of the actual cost of moving grain, and as a consequence, the railways lack sufficient financial resources to make the necessary investments and improvements in the grain transportation network. Federal Government funds through such programs as the branch line rehabilitation program are being expended but do not solve the basic problem of lack of adequate revenue. In addition, the statutory rates favour the shipment of six major grains and discourage crop diversification and agricultural processing in the west.

Additionally, westbound shipments of major products are forecast to triple in total within the next ten years. Investments of about \$13 billion will be required in the western part of the national rail system.

At the present statutory rates the railways are projected to lose \$2.4 billion on grain traffic in the next four years despite Federal Government expenditures on branch line subsidies. Some \$208 million was expended on those subsidies in 1980 alone, and \$1.5 billion on other railway assistance programs in the last decade.

In response to growing concerns about the western grain network and inadequate future rail capacity if nothing was done, and after extensive consultations with organizations in western Canada, the Government of Canada concluded that there was a general recognition of the urgency and need for a comprehensive approach to deal with western grain transportation and the broader capacity problem. The approach would require significant contributions from the Federal Government, the producers and the railways. The Government decided to commit a total of \$3.2 billion over the next four years and, through a formal consultation process, invited the producers and the railways to consider the extent of their contributions.

The Minister specified seven principles as a basis for arriving at a solution:

1. A statutory framework should be created by Parliament to give effect to the new arrangements, and specifically to provide a basis on which adequate compensation to the railways for moving grain could be established at the earliest possible date.
2. In accordance with proposals made to it by the major producer organizations in Western Canada, the Government of Canada is prepared:
 - a) To commit itself by statute to the payment on an annual basis of an amount equivalent to the 1981-82 shortfall in railway compensation; and
 - b) To enter into discussions with the producer organizations and the railways concerning ways of meeting cost increases incurred in the fiscal years beyond 1981-82.
3. While the Government is prepared to bear a substantial part of the cost of grain transportation in future years, its resources are limited. An increased contribution by grain producers will be required.
4. In return for being compensated, the railways will be required to take action on several fronts, including:
 - a) performance and service guarantees related to grain transportation;
 - b) commitments regarding additional investment programs that would be undertaken;
 - c) adjustments to other rates in order to promote agricultural diversification and processing in western Canada; and
 - d) presentation of data concerning their revenues, costs and investment plans.
5. The economic distortions within the agricultural sector stemming from the statutory rate should be reduced, without recourse to new transportation subsidies for crops not covered by the present statutory rate, or for goods such as livestock and processed agricultural products.

I.

- 3 -

6. The new framework to be developed should promote increased efficiency and economy in the operation of the grain transportation system, and the western railway system as a whole.
7. Nothing in the new arrangements shall affect the existing Government's financial commitment for branch line rehabilitation. In addition, the Government will take prompt action to procure an additional 1,280 hopper cars in 1982.

The Minister identified some of the major subjects to be dealt with in the consultation process:

1. The future responsibility for paying grain transportation costs.
2. The revenues the railways are likely to have available to finance investments in future years.
3. The manner in which the Government will expend its contributions.
4. The kinds of performance guarantees that should be obtained from the railways, and ways of monitoring actual performance in relation to those guarantees.
5. Other measures that could respectively be taken by producers, grain companies, the Government, and its agencies to improve the efficiency of the grain transportation system.
6. The most effective ways of promoting the diversification of the western agricultural economy and processing of agricultural products. In addition to addressing the issue of the statutory rates for grain, the parties should consider ways in which programs of departments such as Agriculture, Regional Economic Expansion, and Industry, Trade and Commerce might most effectively be brought to bear.
7. Possible suggestions from western agricultural associations concerning variable rates consistent, however, with the principle that such rates should not work to the detriment of the individual producer.

I.

- 4 -

8. Ways of ensuring that the level of compensation established from time to time under the new statute adequately protects the interests of producers while providing a fair return to the railways.
9. The elements of the new arrangements that should be incorporated in the legislation to be presented to Parliament at the conclusion of the consultations.

(2) Appointment of the Federal Representative

On February 8, 1982 the Minister announced that Dr. J.C. Gilson as the Federal Representative would lead the consultations with representative groups, particularly western farm organizations and the two national railways. He urged that the consultations be completed by late spring so that legislation might be presented to Parliament by the fall of 1982.

The Terms of Reference for the Federal Representative are as follows:

The responsibility of the Federal Representative on Western Rail Transportation, Dr. Clay Gilson, will be to identify and enhance the consensus among agricultural organizations on a number of issues related to the transportation of grain and to propose to the government specific measures which in his judgement will most effectively achieve the objectives contained in the Government of Canada's Policy Statement on Western Rail Transportation. He should do this through intensive consultation with the major agricultural organizations in Western Canada and the railways. More specifically, he should address with them the subjects in the Policy Statement requiring discussion together with such other subjects he might consider appropriate.

In developing the consensus, the Federal Representative must have due regard for the financial limits contained in the government's statement, especially the total of \$3.2 billion the government is prepared to commit to the Western Railway System over the next four years of which about \$440 million has been committed for branch line rehabilitation and the cost of existing hopper cars. Some of the funds will also be required to procure additional hopper cars. The residual will be the total amount of funds the government is prepared to make available as its share of meeting the cost of transporting grain over the fiscal years 1982-83 to 1985-86 inclusive.

I.

- 5 -

The Federal Representative shall determine the appropriate procedure for the consultative process in order to accomplish the objectives outlined above.

The Minister of Transport will assume primary responsibility for consultation with the Provincial governments concerning subjects related to western rail capacity. The Federal Representative may at his discretion seek information or advice from provincial officials.

He will advise the Minister of Transport on the progress of the consultations on a regular basis and will seek Ministerial approval on those subjects which might require it during the consultative process.

At the conclusion of the consultative process, the Federal Representative will report to the Minister of Transport on the results of his consultations and make recommendations relating thereto.

The Federal Representative will also be available to provide the Minister of Transport and other Ministers with advice on implementation of the western rail transportation policy including advice on required legislative measures.

The Federal Representative will be based in Winnipeg and will be provided with an office and support services to be funded out of an overall budget for his office. All salaries and expenses, with the exception of those of the Federal Government employees, will also be funded from this budget.

(3) Organizations Included in the Consultation Process

The Federal Representative invited twelve organizations to participate in the consultation process and to send representatives to an initial meeting on March 10, 1982. These included the two national railway companies, one group of processing companies and nine major farm organizations.

The processing group consisted of five companies engaged in the crushing of canola. They operate a total of eight plants in the three Prairie provinces.

The farm organizations included the four large farmer owned grain elevator companies which have as members and/or patrons a substantial majority of the grain farmers of western Canada. The companies are United Grain Growers, Manitoba Pool Elevators, Saskatchewan Wheat Pool and Alberta Wheat Pool. All four are controlled by farmer members

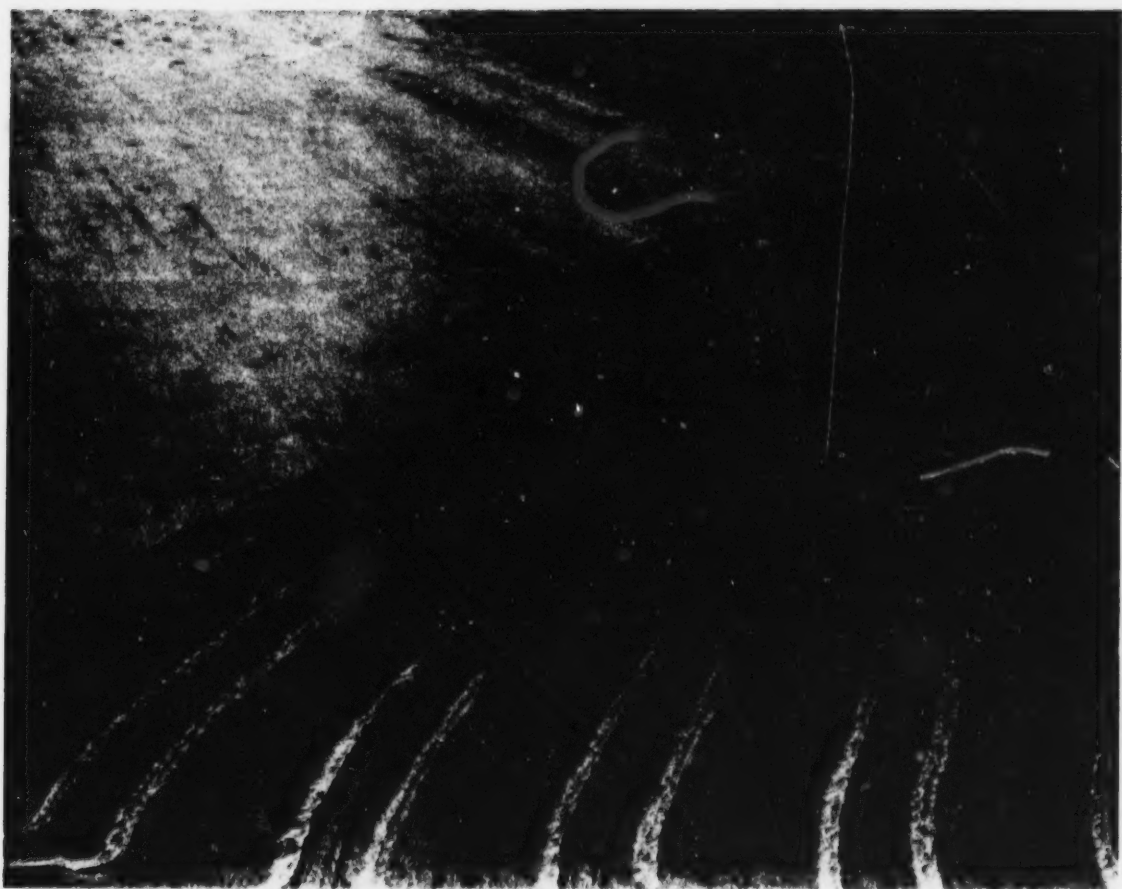
through a system of elected delegates and directors and represent the interests of farmers in the transportation system as well as their interests as owners of grain handling facilities at the primary and terminal levels, important interdependent elements of the grain marketing system.

Four of the farm organizations represented from ten to nineteen constituent organizations almost entirely made up of farmers and their commercial organizations. A total of 64 organizations were represented, nine of them through membership in two or more umbrella organizations. The Western Agricultural Conference represented, directly or indirectly, a total of 43 organizations in addition to six of the largest farm organizations which participated directly in the consultations. The constituent organizations consisted primarily of farm supply, marketing and service co-operatives, farmer commodity associations and producer marketing boards. A small number were municipal or womens associations or farm business organizations. Two were agri-business industry associations in the farm supply field. The Prairie Farm Commodity Coalition represented 12 constituent commodity associations. These associations were formed by farmers to promote the production and marketing of their specific products.

Two direct membership general farm organizations were invited to participate in the consultations. Unifarm with a direct membership of 7,213 as well as fifteen association members, accepted the invitation. The National Farmers Union did not attend the consultation meetings but did submit a written brief for consideration by the Federal Representative.

Invitations were extended only to major farm organizations to participate in the consultation process. The tight time frame of the exercise did not permit direct consultation with a large number of organizations individually. The organizations that participated represented a large proportion of the producers in western Canada and reflected the viewpoints of a broad cross-section of groups with differing interests in the future arrangements for rail transportation of agricultural products. Other interested groups from western and eastern Canada provided input and made their views known through written submissions to the Federal Representative.





II. WESTERN GRAIN TRANSPORTATION - AN OVERVIEW

(1) Prairie Agriculture in the Canadian Economy

Prairie agriculture is a significant component of the Canadian economy, contributing substantial export earnings, and supporting other domestic economic activities through the demand for goods and services. Total rural population on the Prairies exceeds 1.2 million people.

In 1981, farm cash receipts on the more than 150,000 farms in Manitoba, Saskatchewan and Alberta were \$9.5 billion, constituting one-half of the Canadian total. Further, Prairie agricultural production accounts for the bulk of Canadian agricultural exports which in turn were 11% of all Canadian exports in 1981. The fourth-leading export commodity in 1980 was wheat, valued at \$3.8 billion, accounting for more than 40% of total agricultural exports. Additionally, some 93% of Canadian production of the 6 major grains (wheat, oats, barley, rye, flaxseed and canola) comes from the three prairie provinces. Approximately 44% of total Canadian agricultural employment is on the Prairies, with prairie farm operators representing nearly one-half of the Canadian total.

The total value of 1981 Prairie crop sales was \$6.4 billion with wheat sales totalling \$4.2 billion, barley sales \$882 million and oilseed sales of \$713 million. Crops contributed two-thirds of Prairie agricultural sales.

The Prairie region supplied livestock and livestock products valued at nearly \$2.0 billion or one-third of total Canadian production in 1981. Cattle sales were \$1.9 billion, hog sales \$415 million and dairy product sales were \$320 million.

The processing of agricultural products in the Prairie region involved total sales of \$5.8 billion and contributed \$1.2 billion or 20% of total value added in manufacturing in 1980. There were more than 800 plants engaged in food processing employing over 32,000 people and paying \$500 million in wages.

Agriculture is a heavy user of inputs provided from other sectors of the economy. In 1981, Prairie farmers spent on goods and services and paid in taxes and wages a total of over \$5.6 billion (excluding depreciation), most of it paid to firms and individuals outside the farm sector. These expenditures included \$1.3 billion for machinery, repairs and fuel, \$1.1 billion in interest, \$638 million for fertilizer, \$268 million in wages and \$133 million in property taxes. The level of economic activity in the region is strongly affected by the levels of gross receipts from farm product sales and farm purchases financed therefrom.

II.

-2-

The value of Prairie agricultural production is variable, following closely the fluctuations in world prices for such commodities as wheat. Besides world production and economic conditions, physical production varies with weather. In recent years, the degree of variability in Canadian farm incomes has increased sharply. From 1955 to 1970, the average annual change in net farm income was approximately 10 percent. In the 1970's, it was 24 percent. Much of that variation was related to income from grain exports. Despite these fluctuations, western agriculture contributed substantially to the national economy each year.

(2) The Statutory Rate Problem

The most critical issue facing western Canada today in its economic development is the future adequacy of the rail transportation system. Agriculture, particularly grain, remains central to the Prairie economy and the prospects of western Canadian farmers depend in large measure on exports and the ability of the railway system to move the grain to export points. In the past decade, a serious grain transportation problem has emerged. Its origins are related to the statutory Crowsnest Pass Rates. The statutory rates have become a western farm problem though they have been a significant historic benefit.

It is critically important that the problem be overcome. The future welfare of western Canadian farmers depends upon its resolution. Indeed, the problems of western grain transportation should be viewed first and foremost from the perspective of western producers. The continued existence of a vigorous and healthy western farm economy depends upon the grain transportation system and all of its component parts. Western producers face considerable variability in international markets and prices. They must meet international competition and adjust to the pressures of the world markets and to the costs of producing and marketing their produce. The railways provide their only volume access to those markets and if crops or products do not move, for whatever reason, it is the producers who lose the sales, pay for the storage and adjust to changed market circumstances.

Recently, western producers have been expanding their production and the volume of their sales in response to rising world demands. There is a growing potential to diversify production and to expand processing in the west. Although not all western producers view the statutory rate problem in the same light, they recognize that the transportation system has been inadequate in the past and that substantial sales have been lost or deferred. They are seeking a system with the assured capability of moving an average crop each year. They want a system that allows them to produce and market whatever crops and live-stock are in current demand and permits appropriate products to be processed in the west. Above all, they want a system that performs in their interest - indeed, they see this as an historic right.

The railways also want a strong and healthy western farm economy. But the statutory rate poses special problems for them. In the first place, the railways lose money moving statutory grain and their losses are increasing as a result of inflation and volume increases in movement. They have found themselves unable to maintain their plant and equipment. Consequently, there are capacity constraints not only in the grain transportation network, but in their total system, and inadequate incentives to expand in a business-like manner despite the increasing need for their services. In short, they face a crisis in financing and rail capacity. This will impact on their users, the shippers of grain, coal, sulphur, potash and other bulk commodities.

The grain handling system, the elevator companies, the terminal operators and the companies that process and move grain forward, in whatever form, are also faced with pressure to consolidate, to modernize their plant and to invest in expansion. They wish to operate their enterprises in a manner that is responsive to western producers and to their users or customers. Their future is also dependent on a healthy western farm economy.

For all of these groups and for the governments and agencies that support and service them, grain transportation represents an essential element of western Canadian development. The successful resolution of the statutory grain freight rate problem is of paramount importance.

(3) The Origins of the Crowsnest Pass Agreement and Statutory Rates

The early development of western Canada depended on economical and efficient rail transportation for the movement of settlers, their effects and equipment, and of manufactured goods to the west and the transport of grain to ports. Indeed together with tariffs and immigration, transportation was a basic element of the national policy enunciated by Sir John A. MacDonald in the early 1870's. The major rail development, the construction of the transcontinental railway line across Canada which was completed in 1885, predated the Crowsnest Pass Agreement by more than a decade. The Crowsnest Pass Act and subsequent agreement with the CPR to build the railway was passed in June, 1897. Its purpose was to facilitate the development of promising mining areas in southern B.C. and to integrate the areas into the Canadian economy.

The CPR also agreed to make permanent rate reductions on specified westbound settlers' effects and on grain and flour moving east-bound to Fort William/Port Arthur. Grain rates were subsequently lowered below "Crow" levels in 1903-1918 to conform to rates set by the Canadian Northern Railway under an agreement with the Province of Manitoba. Terms of the Crowsnest Agreement were suspended under the

II.

-4-

War Measures Act in 1918 and rates were allowed to rise above the "Crow" level. With grain prices falling, the rates for grain and flour again came under the "Crow" regime in 1922 whereas other rates remained suspended for another two years. The Railway Act of 1919, which gave the railways the power to set rates, was repealed by Parliament in 1925. At the same time, the maximum rate limit on eastbound grain and flour was made statutory. It applied not only to the CPR but to Prairie grain and flour moving eastbound on all railway lines to Fort William/Port Arthur. The Supreme Court had ruled in 1925 that the original agreement applied only to railway shipping points in existence on CPR lines in 1897.

In 1927, the Board of Railway Commissioners extended the Crowsnest Pass rate level to Prairie grain and flour exported by rail through Vancouver and Prince Rupert. In 1931, the statutory rate was applied to grain shipped to Churchill, Manitoba. Also in the period 1927 to 1945, various actions were taken to extend the statutory rate to cover specified by-products of the milling, distilling and brewing industries as well as certain feed grain products. In 1961, the statutory rate was applied to rapeseed, the only addition added by statute as previous additions were made by the Board of Railway Commissioners. Finally, in 1967 the National Transportation Act amended the Railway Act to make statutory the extension of the rate to all exports of Prairie grain and flour though Vancouver, Prince Rupert and Churchill, in addition to the Lakehead.

Current statutory provisions provide for considerably more delivery points at which the rates apply than was originally the case; 1,245 in 1982 versus 289 in 1897. Correspondingly, many more miles of rail line are now included.

This chronology of events relating to the evolution of the statutory rate demonstrates that the rates imposed originally by contract in 1897 and made statutory in 1925, have been extended progressively through the years to provide the current expanded coverage. Although the statutory rates were not specifically intended to provide transportation subsidies to grain producers, or to impose financial losses on the railways, they reflect the concern of the western producers and the Federal Government over the role of grain freight rates in the development of the western economy. During this period and continuing today, the development of alternative modes of transportation and particularly highways, the use of automobiles and trucks, and the advent of aircraft, have made many of the branch lines increasingly grain-dependent. As traffic is switched to other modes, the cost/revenue situation of the railways has been changed as it relates to grain. The development of bulk export tonnage of other commodities such as coal, sulphur, and potash also affects the changing needs of transportation in the west. However, the Prairie branch line system remains largely dependent on grain for the bulk of its traffic.

(4) The Transportation Problem Emerges

There is little evidence that statutory rates posed any serious problems for the western grain producer, the livestock producer, the railways, grain processors or the handling system until the early 1960's. The original agreement and subsequent changes served the west and the railways well for many years. However, that situation appears to have changed.

The decade of the 1960's was characterized by heavy grain carryovers in most years, a moderate expansion in trade and a progressive depression of prices. In 1963/64, the Soviet Union entered the market as a major purchaser of grain. Prices strengthened generally and unprecedented demands were placed on the grain handling and transportation system. By the late 1960's, evidence began to emerge that the system lacked the capacity to serve the needs of the grain industry.

The railways claimed that they were incurring losses on the hauling of statutory grain and on the operation of branch lines. In 1961, the MacPherson Royal Commission on Transportation found those claims to be valid. It recommended that if Parliament decided there was a national obligation to maintain the statutory rates, the railways should be directly compensated for losses incurred by payment of a general subsidy. It found no evidence that assets and earnings of the railway companies in businesses other than transportation should be taken into account in setting freight rates. The recommendation for a general subsidy was not acted upon by government.

A number of special measures were taken in an effort to enhance the performance of the system. The Senior Grain Transportation Committee was formed in 1965, comprised of senior representatives of the grain industry. It functioned as a co-ordinating body to solve specific problems in the transportation and handling of grain. The Grain Transportation Technical Group was established in 1967 to develop a block shipping system which was successfully implemented in 1969. The quota system was modified to facilitate the operation of block shipping and car pooling was arranged to allow Wheat Board grain to be moved to any terminal without regard to the company of origin. These operational changes improved the planning and co-ordination of grain movements and raised the throughput capability of the system.

The National Transportation Act of 1967 implemented many of the recommendations of the MacPherson Commission. It had recommended that the railways be allowed to abandon branch lines. The act provided for the payment of a subsidy for the operation of uneconomic branch lines when applications for abandonment were rejected in the public interest. It did not provide for compensation to the railways for losses on statutory grain movement as recommended by MacPherson.

The Act created the Canadian Transport Commission, one of whose duties was to develop costing techniques to be used in decisions whether to permit abandonment of branch lines. The railways applied for permission to abandon a large number of lines. Though many of these were denied, the subsidy program was not sufficient to prevent further deterioration of many of the branch lines. The railways restricted their investments in the branch line system and in the grain car fleet. The branch lines network deteriorated to the point where many lines became virtually unusable.

The elevator system which was in growing need of modernization was adversely affected by branch line deterioration and uncertainties regarding possible abandonment. Mergers and consolidations occurred but the grain companies hesitated to invest in new facilities until the future status of branch lines was more fully determined.

(5) The Transportation Problem Becomes Critical

Stocks of wheat in Canada exceeded 27 million tonnes at the beginning of the 1970/71 crop year. The Federal Government introduced the Wheat Inventory Reduction Program in 1971 in an effort to bring stocks more into line with demand. By 1972, a closer balance had been reached. Renewed and large volume purchases by the Soviet Union and crop failures in other countries increased the demand for Canadian grain and drove the price to record levels. Production increased and exports reached a record level of 20.5 million tonnes in 1972-73 with very large volumes delivered to the Soviet Union and China.

Pressures on the Canadian Wheat Board increased to meet the growing export demand and concerns were expressed regarding the ability of the transportation system to handle increasing volumes. Growing difficulties in grain movement were affecting sales and consequently producer incomes.

Operational difficulties in the grain handling and transportation system increased despite continuing efforts to co-ordinate movements. The Canadian Transport Commission took over control of most terminal distribution. The railways agreed to co-operate to reduce cross haul between Calgary and Edmonton. The block shipping system, though an improvement over the previous methods, managed to bring only 40% of grain under the plan. It took 11 - 12 weeks in some cases, rather than the planned 6 weeks to fill shipping orders. The system failed to get the right grain to the right place at the right time. It was becoming increasingly unresponsive to the needs of producers.

II.

-7-

The size of the box car fleet declined drastically from 34,000 in 1969 to 12,560 in 1980. The fleet was relatively old and the attrition rate was high. The branch line system continued to deteriorate. The railways had made no investments in rehabilitating grain rolling stock or branch lines since the early 1960's. Maintenance work was minimal throughout the system. Train speeds were reduced and efficiency further declined at a time when export volumes were expanding and prices were more favourable than they had been for years.

Despite a considerable consolidation of country elevators, shipping points and grain companies, the handling system was under increasing strain. Road improvements, the greater use of trucks, the advent of higher throughput elevators, increasing labour costs and the abandonment of branch lines created pressures to consolidate facilities in order to improve operating efficiencies.

Lost sales were estimated at \$400 - 600 million in 1977/78 and at \$600 million in 1978/79. Demurrage costs were \$20 million in 1978. Deferment of sales resulted in increased storage costs. Grain producers' incomes were reduced as a result of the inability of the system to handle greater volumes. Only low volumes of other railway traffic and the provision of several thousand hopper cars by the Federal Government permitted the railways to move record volumes of grain.

As grain inventories were reduced from the high level of 1970, world market prices not only rose but were more fully reflected back to the farm level. Livestock feeders and grain processors in the west who provide an important market for Prairie grain had been paying relatively low prices in circumstances of limited markets and low delivery quotas. Farmgate prices increased sharply with world market prices and the fixed statutory freight rates were fully reflected in local prices. These rates tended to discourage the feeding and processing of Prairie grain within the region. For similar reasons, the production of crops not covered by statutory rates was also discouraged.

Recognizing the growing seriousness of problems in the system the Federal Government took a number of steps to try to cope with them. Several studies were commissioned to review the operations of the system.

In 1976, the Snavely Commission on the Cost of Transporting Grain By Rail reviewed the 1974 railway costs. It determined that the railways were losing substantial amounts of money in the carriage of grain. The results of the study were later updated for 1977 and 1980 and showed substantial increases in the amounts of losses.

II.

-8-

In 1975 the Hall Commission on Grain Handling and Transportation was appointed to study the rail needs for Prairie communities and to make recommendations regarding the future of the branch line network. In 1977, it recommended that approximately 2,200 miles of branch lines be abandoned and that 1,800 miles be kept as part of the basic rail network guaranteed to the year 2000.

It also recommended that the remaining 2,300 miles of branch lines be placed under a new body the Prairie Rail Authority. It further recommended that the Federal Government pay a grain subsidy to the railways and that the statutory rate be maintained and extended to cover other agricultural commodities.

In 1978, the Prairie Rail Action Committee was established to review the branch lines whose status was left in doubt by the Hall Commission and to recommend on their future in order that uncertainties might be reduced. It recommended that a further 1,000 miles be added to the basic network and that the remaining 1,400 miles be subject to abandonment proceedings. Following the Neil Report, another 600 miles were added to the basic network. This resulted in the guarantee of approximately 16,000 miles of rail line to the year 2000.

A study by Booz Allen and Hamilton was commissioned in 1979, to analyze the existing and future operation of the grain handling and transportation system. The study was both intensive and extensive though the statutory rates, Canadian Wheat Board marketing and marine shipping arrangements were excluded. It made many recommendations for improved information, planning and control systems, for the purchase of an additional 9,300 hopper cars and for the construction of additional terminal capacity on the west coast. It also recommended the establishment of a Grain Transportation Improvement Task Force to expedite the implementation of improvements.

The railways, because of a severe revenue shortfall, made little or no investment in the grain-related system during the decade but a number of ad hoc measures were taken by the railways, financed mainly by the Federal Government.

A branch line subsidy program was authorized in the National Transportation Act of 1967. The first payments were made in 1970 on grain-dependent branch lines retained in the public interest after abandonment applications were rejected. This was the first financial contribution related to losses by the railways on services for moving grain. In the period 1971 - 1981, both CN Rail and CP Rail received substantial subsidies, totalling \$971 million.

In the summer of 1977, the Federal Government began an upgrading and rehabilitation program for the lines in the basic branch line network at that time. A total of some \$700 million was committed to the program which was expected to take eight to ten years to complete. It was agreed that 1,300 miles of CP and 1,015 miles of CN lines would be rehabilitated. Up to March 31, 1984, CN Rail will receive \$298.1 million and CP Rail will receive \$196.8 million under this program.

In 1974, the Federal Government and the railways began a cost-shared program to repair over 7,400 box cars to provide a continued grain service. This was in addition to a Federal Government program to purchase new grain hopper cars begun in 1972. By 1981, it had purchased or leased a total of 10,000 cars. Even this program was not enough to overcome the deficiencies in rolling stock. In 1979, the Canadian Wheat Board purchased 2,000 hopper cars at producers' expense. The provinces of Alberta and Saskatchewan each purchased 1,000 hopper cars and Manitoba acquired 400 cars on short-term lease.

Other measures were taken in response to a growing crisis in the grain handling and transportation system, aggravated in fact by the existence of statutory rates. In 1976 the Government began a program to reimburse canola processors for the difference between minimum compensatory freight rates for canola oil and meal and the statutory rate which was in effect for raw rapeseed and meal to Thunder Bay. A number of significant port improvements were made on the west coast, at Churchill and at Montreal through a combination of private and Government initiatives. Western grain handling companies, private and co-operative, took steps to develop a Prince Rupert Terminal with assistance from the Federal and Alberta Governments. Projected export volumes exceeded the capacity of existing rail and terminal facilities. Development of the terminal at Prince Rupert would help to ensure that the port system would have the physical capacity to handle the larger volumes of grain expected in the near future.

The problems of moving grain became even more critical in the early 1980's. Record export levels were expected for 1981-82. The Canadian Wheat Board estimates that 30 million tonnes will be exported in 1985 and 36 million tonnes in 1990. Difficulties in co-ordinating and planning the movement of current volumes led the Federal Government to create the Grain Transportation Authority in October 1979. The GTA began operations in March 1980. It has a major role in the car allocation function, particularly for the allocation between Board and non-Board grains and among shippers of non-Board grains. One of its major objectives is to carry out the required planning and to implement the changes necessary to make the forwarding system operate more efficiently and effectively, and to increase system capacity to meet the 1985 target of a 50% increase in exports.

(6) The Need for Action

Developments of the last two decades demonstrate the extent and seriousness of the western grain transportation problem. The numerous, ad hoc programs and authorities created to deal with handling and transportation issues were indications of problems emerging, partly at least, because of deterioration of the system. The extraordinary effort and expense put into an attempt to create an acceptable system provide clear evidence of revenue limitations. The system was no longer responsive to the needs of the grain industry and generally lacked incentives for improvement. It had become excessively bureaucratized and was failing to adjust, improve and modernize. Performance was less than satisfactory and there was no reason for doubt that the fixed statutory rate had contributed significantly to the deficiencies of the system.

The grain producer is no longer assured of an adequate and responsive system to move his crop. Fixed transportation rates result in an additional burden for the hard-pressed livestock producer. Those producers wishing to diversify production to crops not eligible for the low statutory rate are discouraged by the higher charges for moving alternative crops. The low rates for transporting the major grains encourage processing outside the west, to the detriment of the western economy. The canola-crushing industry is experiencing increasing problems in competition with its products abroad, due partly to the disparity in freight rates in favour of unprocessed seed. Below-cost rates provide a disincentive to railway investment. The government ad hoc programs to overcome these deficiencies are no longer fully effective and are becoming exceedingly costly. As each new problem has emerged, its ripple effects are being felt more widely in the agricultural sectors and throughout the western economy. A persistent high level of inflation is profoundly aggravating these difficulties.

Despite progress in renewing and expanding the transportation and handling system, operational deficiencies are still being experienced. The system is complex and involves a combination of private, co-operative and public ownership. Agricultural production and marketing is dynamic and the system must change and expand to meet the needs of the 1980's. The record of periodic deficiencies and ad hoc programs is stark evidence of the difficulties experienced in responding to changing circumstances and opportunities.

Many factors have contributed to this situation, but the statutory rate issue is central and is the most significant of these. Despite a series of ad hoc federal measures during the 1970's, the future of the western rail network is still confronted with serious problems. A new surge of western bulk exports is forecast for the 1980's and massive expansion of the transportation system is required, particularly in the West. Grain forms a part of this increase and should also contribute to the financing of expansion if western grain producers are to obtain the services they require.

II.

-11-

The western livestock producer should not be placed at a disadvantage due to below cost grain rates. Further, crop diversification and processing in the west should be encouraged and certainly not discouraged by transportation policy.

All governments are faced with the need to exercise expenditure restraint. Since 1971, the Federal Government has provided funds for branch line subsidies, hopper car purchases, branch line rehabilitation and other related programs totalling in excess of \$1.8 billion dollars.

Investments in the handling system by the private sector and co-operatives have been significant and can be expected to continue if an expanding and responsive system is put in place. Further investments by the railways is essential and must be assured. These developments point to the need for a fair and comprehensive solution to the statutory rate problem.

The opportunities in western Canada for expanding grain and livestock production, for crop diversification, and for greater processing of grains and livestock are being limited, in part, by the current freight-rate structure. Producer groups are pressing strongly for a comprehensive and balanced solution taking into account the historic role that transportation has played in the development of the West.

Against this summary of highlights relating to grain transportation problems, programs and institutional changes during the past 20 years, and in relation to the projected inadequacies of the western railway system to respond to the needs and opportunities of the Prairies, the Federal Government has set out a comprehensive approach to meet western Canada's future railway needs. On February 8, the Minister of Transport announced the beginning of a consultation process leading to a new statutory framework for the sharing of grain transportation costs among the Government of Canada, the railways and the Prairie grain producers. The Minister stated that the Government is seeking an equitable framework within which the railways, the users and itself can share in the task of expanding western railway capacity to meet the heavy demands that are expected in the years ahead from a growing western economy.



III. THE CONSULTATION PROCESS

(1) Establishment of Office and Secretariat

The first task of the Federal Representative was to establish and staff an office to support him in his consultations with the participating organizations.

E.W. Tyrchniewicz from the University of Manitoba was appointed as Co-ordinator of Analysis. Donald A. Leitch was retained as Executive Assistant to the Federal Representative. George McLaughlin was seconded from the Canadian Grain Commission and Richard Wansbutter from the Grain Transportation Authority to undertake professional work within the secretariat. Other professional staff from Government departments and other organizations were drawn upon as required (see appendix).

(2) Schedule For The Consultations and Report Preparation

The limited time available to complete a complex consultation process with several organizations representing diverse interests made it necessary to plan the work schedule, break it down into sequential stages and allocate specific time intervals and deadlines for the completion of each stage. Four phases were planned for the 112 days available for the total project. These divided the work into phases of preparation, informal consultation, formal consultation and report preparation.

Phase I covered the period from February 8 to February 28, 1982. In that period the major tasks completed were the establishment of the office, the staffing of the secretariat, the scheduling of the consultation process, the drafting of operational procedures and the preparation of the list of organizations to be invited to participate in the consultation process. The phase ended with the distribution of the proposed schedule and procedures to the participants and the invitations to them to attend a general meeting on March 10th in Winnipeg.

It was proposed that each participating organization designate a principal representative and an appropriate number of advisors. Participating organizations were invited to prepare written submissions relating to Mr. Pepin's Policy Statement and to provide copies which would be distributed to each of the participating representatives.

III.

- 2 -

Guidelines for the preparation of written submissions were provided to the participants. Submissions relating to railway costing and railway guarantees were to be sent to the Western Grain Transportation Office by March 19th and submissions relating to other matters by March 31st, 1982. A format for the submissions was suggested. They included comments and suggestions relating to the principles specified in Mr. Pepin's Policy Statement of February 8th. They also included comments on and recommendations, with supporting analysis, relating to the "major subjects" for consultations outlined in the policy statement. Finally, they included other observations and comments relating to the consultation process.

Phase II was scheduled for the period March 1st to March 31st, 1982. This period was devoted to informal consultations with participating organizations and to the development of an acceptable method and effective procedures for the formal consultation process for which there was no direct precedent. The Federal Representative met informally with each of the various organizations during the month of March and formally with all participants in a general meeting on March 10. He also consulted with other groups and organizations not involved in the formal process.

Two technical seminars were held at the Winnipeg offices during this period. The first dealt with railway costing as contained in the updating of the Snavely Cost Study (1980). The second was devoted to a discussion of five Technical Working Papers prepared for the Federal Representative as background information relevant to the consultation process.

Phase III constituted the formal consultation process and occupied the period from April 1st to May 14th, 1982. A series of meetings attended by representatives of all the participating organizations was held at the Winnipeg office. Formal Summary Records were prepared after each meeting. Priorities were set out in agendas for subsequent meetings in an effort to arrive at broad areas of agreement.

Phase IV extended from May 14th to June 14th, 1982. A summary report on the consultation meetings was prepared and distributed to the participants. A final meeting of the representatives was held May 20-21st to discuss this report prior to the finalization of the report of the Federal Representative for submission to the Minister of Transport.

III.

- 3 -

(3) Preparation of Technical Working Papers

At the request of the Federal Representative a series of five Technical Working Papers was prepared by selected experts including Federal Government officials. The purpose of the papers was to bring together available information on the major issues raised by the Minister's Policy Statement, to identify clearly the issues for discussion and to set out the major options and their probable consequences. No policy conclusions or recommendations were included.

The papers were prepared by experts in the various areas and release did not necessarily imply agreement with the analysis and related assessment. Those papers prepared by professional staff from the Federal Government were not approved at the Ministerial level and did not purport to reflect or represent Government policy.

The papers prepared and distributed were:

1. Railway Performance Guarantees
2. Grain Transportation and Handling Efficiency Measures
3. The Effect of Transportation Cost on Farm Income and Expenses in Western Canada
4. Assessment of Alternative Compensation Mechanisms
5. Agricultural Growth Potential for the West with Crow Rate Adjustments

A sixth paper was subsequently prepared and distributed "Legislative Framework Needed to Give Effect to New Grain Transportation Arrangements".

The Technical Papers were distributed to the participating organizations and formed the basis for a two day seminar to which the representatives and their advisors were invited as well as other experts who could provide additional useful input into the discussions. Copies of the Technical Working Papers and briefs from the participating organizations were deposited in Transport Canada offices in Winnipeg, Regina, Saskatoon, Calgary, Edmonton, Vancouver and Ottawa for public review,

(4) First General Meeting of Organizations

The First Formal Meeting of Representatives was held at the Western Grain Transportation Office on March 10, 1982. Representatives of all invited organizations except the National Farmers Union were in attendance.

III.

- 4 -

The primary purpose of the meeting was to discuss the proposed plans of the Federal Representative for the carrying out of his assignment as set forth in his Terms of Reference. Discussions were held respecting procedures for the conduct of meetings, public information, scheduling, the distribution of briefs and informal discussions to be arranged by the Federal Representative with each of the participating organizations. It was agreed that formal meetings would be held in camera and that specific discussions and exchanges of views would be treated in confidence. The interest of the public was recognized but it was felt that private meetings were more conducive to full exchanges of views and the development of consensus positions on the various issues. Participants were of course free to discuss publicly the positions taken by their own organizations.

Dates for seminars and the next formal meeting were agreed to as were the deadlines for the submission of written briefs.

The seven principles of the Federal Policy Statement were also discussed. Concerns were raised regarding the interpretation and implications of some of the principles. The Federal Representative agreed to seek clarification, particularly as to the Federal Government commitment to share in cost increases beyond 1986. He undertook to transmit the information to the participants as soon as possible.

(5) Informal Consultations

After the first general meeting of the participants on March 10th, the Federal Representative held informal discussions with each of the organizations involved in the consultation process. Meetings were held jointly with the two railways and individually with each of the other organizations. Dr. Gilson and members of his secretariat met with the official representatives, their advisors and other executives or management personnel, usually at the home offices of the respective organizations.

The main purpose of the informal meetings was to review the procedures to be followed throughout the consultation process and to receive suggestions from the participants for modification or additions thereto. The discussions also involved explanations of the purpose of the Technical Working Papers being prepared.

A second purpose of the informal meetings was to enable the Federal Representative to learn firsthand of the concerns of each organization so that he might be better able to expedite progress in the formal general meetings.

(6) Formal Consultations

In addition to the First Formal Meeting of Representatives of the participating organizations on March 10th, six more formal meetings of the group were held in Winnipeg: April 7-8, April 15-16, April 27-30, May 6-7, May 11-14 and May 20-21.

These meetings moved progressively from a clarification and understanding of individual items and issues to attempts to shape and develop guidelines outlined in the Federal Government Policy Statement of February 8.



IV. THE BACKGROUND ISSUES

IV. (1) Transportation and Agricultural Development

Throughout the consultation process the potential for agricultural growth and development was recognized as an important issue. It was debated in the technical seminars, discussed in most of the written submissions, and reviewed again in the formal meetings. In the course of the consultations it was generally agreed that there is potential for expanded agricultural development in western Canada and that transportation rates will have some impact on the extent and direction of that development. Following is a general review of the potential for agricultural development in western Canada.

a) Potential for Grains and Oilseeds

The technical paper dealing with the growth potential for grains and oilseeds suggested that, if adequate grain handling and transportation facilities are in place in the future, all of the major Canadian grains and oilseeds available for export could be sold in the world market. It concluded that the Canadian Wheat Board export targets (for the major Canadian grains and oilseeds and their products) of 30 million tonnes by 1985 and 36 million tonnes by 1990 provide useful planning parameters.

b) Potential for Special Crops

In the context of the consultations, the term "special crops" referred to those crops produced in western Canada other than the six major grains and oilseeds (wheat, oats, barley, rye, flaxseed, and canola).

The technical paper on this topic stated that the production of special crops has been stimulated by restrictive delivery quotas for the major crops (a symptom of grain surpluses) and advances in the production technology associated with special crops.

It was anticipated that there will be significant increases in the acreage planted to special crops to 1985 and 1990 as farmers become more familiar with them and as further technology improvements facilitate their production and increase their profitability. By 1990, production of special crops in western Canada could be more than two and one half times the one million tonnes recorded in 1981. However, the relative increase in the production of the individual crops will vary markedly reflecting specific market opportunities.

c) Potential for Livestock

The potential for growth in the western Canadian livestock industry was also thoroughly discussed and debated during the technical seminars and also during the formal consultations.

It was recognized that the western livestock industry had experienced many ups and downs in the past, many of these attributed to the instability of grain prices which had resulted. These surpluses and reduced grain sales had induced grain farmers to produce livestock during periods of depressed grain income. However, if the projected grain exports are realized, grain carryovers will generate less instability in livestock productions in the future. It was pointed out that with compensatory rates the locational and comparative advantage of the livestock industry in western Canada could be more fully captured, leading to expanded production and exports from the region.

There is no practical limit to the size of the potential market for western Canadian livestock production. Canadian livestock competes in the North American and world markets and there is a significant potential for expanding markets in some regions which import meat and meat products, specifically the United States. Though per capita meat consumption has decreased recently, this trend is likely to reverse with advances in purchasing power and as supply expands. As world population increases and the global supply of food becomes more critical, the prices of livestock will certainly rise to offset the higher costs resulting from the growing demand for and price of grain for human consumption.

In general, the conclusion was for a positive potential of indeterminate size for the western livestock industry. Representatives of the livestock industry believe that a move to compensatory rates would be beneficial for the industry.

IV.

- 3 -

d) Potential for Agricultural Processing

During the consultations the processing industry dealt with in most detail was the oilseed-crushing industry, primarily because of the freight rate anomalies that currently exist. However, the other types of agricultural processing in western Canada were reviewed in the technical paper and seminar.

As pointed out in the technical paper, the agricultural processing industry is very significant in western Canada, employing 20% of the work force in manufacturing; the meat processing sector being the largest of the agricultural processing industries. Its potential, of course, is determined largely by the potential for the western Canadian livestock industry. The potential for the feed manufacturing sector is also tied to the future of the livestock industry.

It appears that the malting industry will continue to experience sufficient export demand, to permit it to operate its plants at close to capacity. However, the Canadian flour milling industry has witnessed declining export demand, a trend not likely to be reversed.

The canola-crushing industry in western Canada has expanded considerably in the past decade. Total crushing increased from less than 200 000 tonnes in 1970 to almost 1 million tonnes in 1980. By 1990 the industry could be crushing 1.5 million tonnes of canola.

IV.

- 4 -

IV. (2) Distributional Impact of Statutory Rate Structure on Agricultural Development

a) General Distributional Impacts

The freight rate structure for grain has a direct impact on most of the agriculture and agricultural processing sectors in western Canada. Those sectors will be further affected by any future changes to the statutory rate. The statutory rate structure can assist, hinder or be neutral in its effects on western Canadian economic activity. The distribution of those impacts is critical to the discussion of payment of the railway revenue shortfall.

For example, the production of statutory grains and oilseeds for export is more profitable than it might otherwise be if the grain freight rate were at compensatory levels. Similarly, the production of statutory grains and oilseeds sold within the Prairie region is also more profitable than it would be at compensatory freight levels. Competition for the grain and pricing is affected by the statutory rate which, in general terms, is backed off the export price to arrive at the Prairie price for the grains.

It has been agreed that the production of grains and oilseeds moving under statutory rates is currently more profitable than would otherwise be the case with a higher freight rate structure. An increase in the freight rate would result in increased costs and decreased returns to the statutory grain producers, relative to what would have occurred under the current rate structure. Levels of production and export may or may not be affected.

While producers of statutory grains generally perceive a positive benefit from the statutory freight structure, there are those in the agricultural sector who view the current rates as a negative factor. For example, livestock producers in western Canada who buy grain on the Prairies argue that they pay a higher price under the statutory freight rate structure than they would otherwise pay with a compensatory freight rate structure. Producers of other non-statutory grains are at a competitive disadvantage as they do not have the benefit of reduced freight rates and as a result have a lower return to the producer after paying transportation costs.

IV.

- 5 -

The oilseed-crushing industry in western Canada is affected because of the anomalies in the current arrangements for statutory shipment of all shipments of canola oil and meal at statutory rates. Additionally, the oilseed moves at statutory rates for export, and to eastern Canada, thereby creating a competitive disadvantage for the crushing industry in western Canada. Because the products of crushing have higher freight costs than the exports of seed, the crushers must operate at a lower profit level than would otherwise be available.

In those processing industries where equivalent rates apply to both the raw and processed products, e.g., flour milling, the statutory freight rates would appear to have been a neutral factor.

The railways are adversely affected because of the lower level of revenue they receive at statutory rates than at compensatory rates. Producers of grains are then indirectly affected if the railways are unable to provide the required service, maintenance of lines, and investment.

Table IV-1 lists all the grains and grain products moving under statutory rates from the Prairies.

IV.

- 6 -

TABLE IV-1

GRAIN, OILSEED AND PRODUCTS THAT QUALIFY FOR STATUTORY
FREIGHT RATES FROM WESTERN CANADA

<u>Commodity</u>	<u>Commodity</u>
Barley	Speltz
Buckwheat	Wheat
Corn*	Hulls, Sunflower Seed, Ground*
Flaxseed	Linseed Meal*
Oats	Linseed Oil Cake*
Barley Cleanings	Linseed Oil Cake Meal*
Barley Meal*	Malt (made from Grain only)
Beet Pulp, Dried, Sweetened or not Sweetened*	Middlings
Bran	Millfeed
Breakfast Foods or Cereals (uncooked)	Oathulls
Brewer's Dried Grain*	Oatmeal
Chopped Feed	Pearl Barley
Corn, Cracked*	Pot Barley
Corn Meal*	Rapeseed Oil Cake*
Crushed Barley	Rapeseed Oil Cake Meal*
Crushed Oats*	Rapeseed Screenings*
Distillers' Dried Grain*	Rolled Oats
Feed Grain, in sacks	Rolled Wheat
Feed, Animal and/or Poultry*	Rye Meal
Flaxseed Screenings	Shorts
Flour (made from Grain or Malt only)	Soya Bean Meal*
Grits	Sprouts, Barley
Groats	Sunflower Seed Oil Cake*
Rapeseed	Sunflower Seed Oil Cake Meal*
Rye	Sweepings and Screenings
Seed Grain, in sacks*	Weed Seed Oil Cake*
	Weed Seed Oil Cake Meal*
	Wheat Germ*
	Wheat Meal

* Statutory rates apply to movements to Thunder Bay only.

IV.

- 7 -

b) The "Crow Benefit"

The statutory freight rates for grain are perceived as providing broad economic benefits to western grain producers and consequently to the economy of western Canada. There are also disadvantages flowing from the current rate structure. The previous section outlined in general terms the positive and negative effects of statutory rates on the various agricultural sectors.

Simply, the statutory grain rate is viewed as having benefited the Prairies by encouraging increased grain production and by providing higher net returns to producers of statutory grains.

In the February 8 policy statement, the Federal Government commits itself to an annual payment by statute of an amount equivalent to the 1981-82 shortfall in railway revenue. For initial discussion purposes, this was assumed to be approximately \$612 million, that being the additional revenues estimated to be required by the railways in excess of the revenue received under the statutory rates to cover their costs of transporting grain. This was assumed to be a measure of the "Crow benefit". The actual amount of the "Crow benefit" to be enshrined in statute was to be determined through consultations with all the participating organizations.

In dollar terms, the "Crow benefit" is defined as being the difference between the total railway revenue requirements for transporting grain and the revenue derived from statutory rates during the base year 1981-82. This is the amount of the benefit the producers of statutory grains received by paying only the statutory freight rates in lieu of freight rates which reflect the costs of the rail transportation services plus a reasonable contribution to constant costs.

The Government's payment of the whole "Crow benefit," if made, would provide the railways with full compensation for hauling grain to export positions and to domestic destinations in eastern Canada as of the base year, 1981-82. As might be expected, there were disparate views amongst the parties on how the "Crow benefit" should be paid, and on the specific quantifications of the "benefit."

The results of the discussions to determine the precise "Crow benefit" for 1981-82 are presented in section IV-4.

c) Views on the "Crow Benefit"

In the consultations, the Prairie Farm Commodity Coalition regarded the total "Crow benefit" as being more broadly based than the above definition since the price of grain and canola traded in the Prairies is enhanced by the effect of the statutory rates. If freight rates are increased, it will affect the value of all grain and canola on the Prairies, whether it is exported or not. In their view, this impact must be recognized in determining the total "Crow benefit" and its subsequent distribution. The PFCC noted that the "Crow benefit" would vary with the volume of grain sold and exported.

The Western Agricultural Conference has also interpreted the existing "Crow benefit" for grain producers more broadly. The WAC recognized the effect of statutory rates on purchases of local feed grains and oilseeds in their suggestions that compensatory rates be applied in the pricing of feed grains on the Prairies. They also recommended that freight rates on raw canola, raw flaxseed and the processed products from those grains be equalized. Furthermore, to correct anomalies in the existing statutory rate structure, they recommended that statutory rates be extended to include special grain and oilseed crops and the processed products thereof.

The Canola Crushers of Western Canada referred to the "Crow benefit" as the benefit accruing to producers from the low transportation rate policy. They noted that the present system discriminates against the producer who wants to support his own value-added agricultural processing plants on the Prairies. The Canola Crushers recommended strongly that the principle of freight rate parity between raw seed and processed products be accepted in whatever rate structure and/or payment arrangements are developed. In particular, they pointed out that the high cost of transporting the oil and meal, over the cost of transporting the raw seed at the statutory rate, has the same effect on the oilseed crushers as the statutory rate has on railway revenues from statutory grain. The Canola Crushers therefore argued that the railway revenue shortfall calculations should be extended to include losses that would be incurred in the transportation of canola products if they were to move at rates equivalent to the Crow.

In the absence of a "market neutral" solution to the statutory rate question, the shipper group, composed of all the producer organizations and the Canola Crushers, felt the parties, other than the railways, who were aggrieved by the statutory rate system should have their grievances redressed through some scheme which would have to be devised. A "pay the producers" solution, which recognizes only the injury done to the producer of grain for export, would be inequitable insofar as it excludes a recognition of the loss of benefits previously enjoyed by producers of statutory grain who had been selling to other than the export market. An equitable solution in the "pay the producers" framework must

IV.

- 9 -

include payment of all lost benefits. Consequently, it was felt that the total payout to producers must be expanded beyond railway revenue shortfall to include these additional lost benefits; this being termed an "agricultural adjustment benefit".

Similar arguments were developed by some participants relating to other existing or potential industries based on grain. In addition, it was suggested by some that since the Prairie and Canadian economies benefit from the existing non-compensatory rates, the "Crow benefit" extends well beyond its impact on Prairie agriculture.

On the other hand, many argued that the Prairies experience an economic shortfall because of the existence of fixed rates for statutory grain which distort the production, marketing and processing of other special crops and livestock. A number of commodity groups indicated that the higher prices received by Prairie grain producers as a result of the fixed statutory rates represent higher costs to the livestock and processing industries.

Most farm organizations stressed the export losses suffered by grain producers from an inadequate transportation system. Many associated these losses with the statutory rates, arguing that the revenue shortfall experienced by the railways has resulted in an inadequate transportation system. Although foregone shipments are not lost in a physical sense, they do represent foregone revenue that can never be fully recaptured, at least in some years. Total production and hence total farm revenue are lower as a result of an inadequate transportation system. Estimates of these losses in the late 1970's range from \$400 million to \$1 billion. These are losses in gross sales which are partly offset by deferred sales at lower prices and involving higher storage costs.

In referring to the effect of statutory rates on crops not covered by the fixed rates, some participants also claimed a loss with respect to these crops from the statutory rates. These arguments are based on the view that special crop producers are placed at a disadvantage in competing for land resources because the net return per acre is relatively less than for statutory crops due to higher transportation costs. There was considerable support for a "resource/market neutral" solution to the statutory rate problems. It was agreed that it was important to ensure the "Crow benefit" would accrue to all those producers affected by the fixed rates or by any changes in the rate regime. A concept of an agricultural adjustment benefit, to include compensation for all lost benefits, emerged from the consultations among farm organizations and the Canola Crushers.

d) Agricultural Adjustment Benefits

The "Crow benefit" presently accrues solely to the producers of grain transported under the statutory rates, in that their net returns are higher because of these rates. The removal of the current statutory rates would result in a reduction in the net income of those producers.

The manner in which the "Crow benefit" or the total railway revenue shortfall is dispersed has significant implications. For example, if the "Crow benefit" is paid directly to the railways, all of the current problems of distortions previously identified remain. The livestock sector continues to have disadvantages in paying higher prices for feed grains. Processing of agricultural products on the Prairies continues to have disadvantages in paying higher prices for grains. The advantage of proximity to sources of supply is reduced. As well, the distortions between production of statutory grains and special crops and other grains continue.

If the "Crow benefit" is paid only to the producers of statutory grains, some of the anomalies and disparities remain. If the "Crow benefit" is paid to all producers of grains on the Prairies, there is a dilution effect; that is, the benefit calculated on the basis of the amount not paid in increased freight rates is dispersed over a wider number of producers, including those who currently do not ship grains under statutory rates. Current producers of statutory grains would suffer a loss of income if the "Crow benefit" as defined is also paid to producers of many additional crops and to producers of grain utilized locally.

It was recognized that producers of all grains and processing industries affected by the current statutory rates, would also be affected by a change to a compensatory rate level. It would be impractical to assume that so sweeping and significant a change in transportation policy could be instituted immediately, and in one step, without expecting some form of compensation or adjustment to be paid. Quite simply, it was argued that the effects of a major change in transportation policy had to be buffered for a short period. Grain producers could not be expected to absorb abrupt changes in a policy that had been in existence for 87 years.

Producers of statutory grains would be immediately affected by a change to compensatory rates through a reduction in their net incomes. Producers of other grains who sell for domestic use lose the equivalent benefit they obtained under the current statutory rates. The prices they receive will be lower by an amount approximately equivalent to the increase of freight rates per tonne.

IV.

- 11 -

Livestock producers on the Prairies who may be disadvantaged because of the statutory rates continue to be disadvantaged so long as the "Crow benefit" is paid directly to the railway. During the consultations, representatives of those groups indicated their willingness to forgo an interim adjustment payment that they had argued they were entitled to, so long as the payment system devised was moving towards a significant portion of the "Crow benefit" being paid directly to grain producers. Their position was that they could continue to accept the current inequitable arrangement for a short period, say 4 or 5 years, if the new framework provided for a resource/market neutral solution at the end of the phasing period.

An agricultural adjustment benefit will be needed to assist grain producers in the transition period from the current situation where they pay statutory rates to the future situation where railways will be receiving compensatory rates. The removal of anomalies, and the reduction of barriers hindering the natural comparative advantages of agriculture in western Canada, will lead to expanded agricultural activity, diversification, and the expansion of processing industries in western Canada.

Under a compromise where payment of the "Crow benefit" would be phased toward greater payments directly to producers (and correspondingly less paid directly to the railways), the calculated agricultural adjustment shortfall payment would start at a specified level in 1983-84 and would gradually phase down to zero by 1989-90. This agricultural adjustment shortfall payment would be designed, in effect, to offset the loss to producers of statutory grains to the extent that payment of the "Crow benefit" would be made directly to all grain producers, that is, the benefit would be diluted.

It is accepted that the Agricultural Adjustment Shortfall payment could be phased out by 1989-90, because a significant proportion of the "Crow benefit" would be paid directly to producers by that time, thus reducing the competitive disadvantage of livestock producers. The dilution effect would be absorbed gradually by the producers of statutory grain, thus avoiding a sharp immediate reduction in the level of benefit received.

In principle, it must be noted, that if the "Crow benefit" is paid directly to the railways for an indefinite period, there would be a need for some type of agricultural adjustment payments to those producers, including livestock producers, disadvantaged by the policy.

IV. (3) Payment of the Railway Revenue Shortfall

As outlined above, the railway revenue shortfall arises from the fact that revenues received from producers who pay the statutory rates are not sufficient to cover the costs of transporting grain. While there are different views on which cost items should be included, there is no doubt that railway costs for transporting grain exceed, by a considerable amount, the revenue from statutory rates.

a) The Railway Revenue Shortfall

In the Policy Statement on Western Grain Transportation, the Federal Government proposed to pay the 1981-82 railway revenue shortfall on a continuing basis as part of the resolution of the statutory rate issue.

In choosing the method of disbursement of the federal freight compensation fund, it is useful to consider the objectives to be achieved. It was generally agreed during the consultation process that the method of disbursement should: resolve the revenue shortfall problem faced by the railways; be neutral in its application; and be simple to administer and well understood. A more complete description of the objectives of the whole "package", or the comprehensive solution, is contained in Section V.(2).

b) Alternative Methods of Disbursement of the Railway Revenue Shortfall

There are two main methods by which the railway revenue shortfall could be paid. One method is to compensate the railways directly for keeping below-cost freight rates to the statutory grain producers. The other method is to compensate the producers directly and they, in turn, would pay a rate sufficient to cover the cost of transporting grain. Either of these two methods of disbursement of the federal freight shortfall fund can achieve most of the objectives noted.

Arguments have been made for and against both of these methods of payment. Details of these arguments may be found in the briefs presented by the participants in the consultation process as well as the Technical Working Paper prepared for the participants.

The manner in which the federal contribution would be distributed was one of the most critical issues addressed in the briefs submitted by nearly all the organizations. It was the major issue on which the farm industry organizations were in least agreement at the beginning of the consultation process.

The provincial farm organizations and the farmer-owned grain companies were generally in favour of the government contributions being paid directly to the railways. Some gave a number of reasons for suggesting that payments be made in this manner. They claimed that the most effective, if not the only effective, way of enforcing performance guarantees on the railways was to make all, or a large part of, the payment conditional on performance. Some felt that if the payments were made directly to producers, they would appear to the public to be a subsidy on grain production and therefore more subject to public opposition and ultimate cancellation.

Other reasons advanced were that this procedure was acceptable to the railways, that it would ensure that revenues are applied to rail maintenance and expansion and that it would ensure that rolling stock is made available for grain movements. Presumably, these assurances would be obtained by making the payments conditional on performance in these respects. Payment to producers on an acreage basis would result in part of the funds going to livestock producers; in effect, an income transfer from grain producers. It was also suggested that it could result in an inter-provincial transfer of income from the predominantly grain-producing regions to the livestock regions of the Prairies.

Other organizations involved in the consultation process opposed direct payment to the railways. They cited a number of reasons for their opposition including: the continuance of a direct impediment to the growth of the livestock industry in the Prairies; discouragement of crop diversification; and growing disincentives for the special crops and livestock processing industries. It was proposed, instead, that the federal contribution should be paid directly to the producers.

The pros and cons of the different methods of disbursing the federal commitment have been recognized for some time among farm organizations in western Canada. Indeed, during 1979 and 1980, the Western Agricultural Conference (WAC) developed a proposal which attempted to reconcile the main differences between the two major methods of payment. The WAC proposal recommended that the difference between the statutory rate and the compensatory rate be paid directly by the Federal Government to the railways. However, to minimize the effect of the statutory freight rates on the western users of feed grains and oilseeds, WAC further recommended that:

- a) The Canadian Wheat Board applies compensatory rates in place of statutory rates in arriving at its corn-competitive asking price for feed grains on the prairies, provided that the price so established is not lower than the local C.W.B. initial buying price; and
- b) Freight rates on raw canola and flaxseed and their processed products be equalized; this equalization being achieved by having the statutory list expanded to include special grain and oilseed crops and their processed products.

Both the WAC proposal and other proposals were debated at length during the consultation process to determine whether some way could be found to bridge the differences between the "pay the railway" and "pay the producers" alternatives.

One alternative, which we shall refer to as the "hybrid proposal", was debated extensively by the participants in the consultation process. Under the "hybrid proposal", some of the shortfall funds would be paid directly to the railways. The payment of this portion of the shortfall funds to the railways would be related, to some degree, to performance, thus providing an obvious and direct incentive for the railways to perform well.

The remainder of the shortfall funds, paid directly to producers, would provide a significant degree of neutrality in resource allocation in agriculture, thus encouraging crop diversification and greater development of grain-using industries on the Prairies.

The hybrid model included a "phasing" provision, with the shortfall payment in 1982-83 going entirely to the railways. Preparations could be made during this interval to develop and refine the administrative mechanisms necessary to calculate and distribute direct payments to producers. Starting with the 1983-84 crop year a portion of the railway revenue shortfall would be paid to producers. The portion of the shortfall going to producers under the "hybrid proposal" would increase to 50% by 1985-86 and, subject to satisfactory performance of the mechanism and general acceptability by producers, this portion could increase up to a maximum of 81% by 1989-90. It should be emphasized that the hybrid model contains the provision that a proportion of the shortfall funds should always be paid directly to the railways, thus ensuring a permanent incentive for the railways to be responsive to the needs of producers and to perform efficiently.

The "hybrid model" included the provision that the method of payment mechanism be reviewed in 1985-86, and every five years thereafter, to ensure that the mechanism was working effectively.

It must be noted that the merits of the "hybrid model" were not necessarily accepted or endorsed by all participants involved in the consultation process. Indeed, some organizations clearly indicated that "pay the railway" was the only official position they could adopt during the consultation process. The hybrid model was developed as a further alternative to the "pay the railway" and "pay the producer" options for the purposes of analyzing the full implications of different payment alternatives.

c) Administrative Considerations

i) Pay the Railways

The payment of the shortfall to the railways will likely be simpler to administer than payment to producers. Firstly, there are fewer organizations to deal with than there are producers. Secondly, the calculation of the payment to the railways and its distribution is more straightforward than the calculation of the payments to producers.

However, it should be noted that there will be considerable administrative work involved in determining and verifying the railway revenue shortfall. To the extent that payment of the shortfall to the railways is conditional upon the achievement of a certain level of performance and service, the administration will be made more complex. The administrative aspects of the railway performance and service guarantees is discussed in more detail elsewhere in this report.

ii) Pay the Producers

There are several methods which may be used in paying the shortfall to producers. Only two of these methods will be selected for examination in this report: the first will be referred to as the direct payment method; the second involves the establishment of a producer freight credit option, to be administered by the Western Grain Stabilization Administration.

1. Direct Payment Option

Since resource neutrality is a key objective, the first method selected for examination was the direct payment option which does not relate the payment in any way to the concurrent production of any particular crops. This neutrality is achieved by relating the individual producer's payments to the cultivated acres in a base year or period, thereby eliminating any incentive under the payment to produce any particular crop. It was concluded that relating the payment to total cultivated acres, rather than acres of statutory crops, would be more equitable. As well as preventing manipulation, relating the payment to past acreage will preserve an historic benefit, i.e., it will not allow the benefit to be shared or further diluted by new acres subsequently brought into production.

In order to correlate the individual's future payment to his current "Crow benefit", there would have to be some recognition of the magnitude of the production/shipments from the land he owns and of the increase in the freight rate which applies to his grain.

Therefore, the share of the total payment made to each quarter section of farmland would be related to the aggregate result of the increase in the freight rate to the nearest shipping point, the productivity of the land as determined by historic yields from crop insurance data, the crop rotation in the region (crop insurance risk area), and the total cultivated acres.

It should be noted that crop insurance productivity factors, although relatively accurate and consistent within each of the Prairie provinces, are not strictly comparable between the provinces. Therefore, it would be necessary that there be an initial division of the funds available for producer payments among the provinces, on some other basis, before the calculations are done for individual producers. Initial division of funds among provinces could be done in proportion to each province's share of statutory grain shipments in some base period.

It is recognized that, because all cultivated land in production does not produce statutory grain which is shipped from the Prairies, the total benefit to the producers of grains transported under statutory rates would be diluted to the extent that payment is based on all acres. In other words, producers of statutory grain would share the "Crow" benefit with other producers. A way of offsetting this effect through an agricultural adjustment payment will be outlined later.

As to whether the owner or tenant should receive the payment associated with rented farmland, it is recommended that such payments should go to the tenant. The reasoning is this: if paying the tenant were initially inequitable to the landlord (possibly the case with some share rental arrangements), he could rectify the situation by subsequently renegotiating and adjusting the terms of the lease.

The question remains as to which administrative body would be best equipped to distribute the payments among the producers. It would appear that the Western Grain Stabilization Administration would be a logical body to distribute the funds, since it already has a large part of the data base required and has several years of experience in distributing stabilization funds to Prairie grain producers.

2. Producer Freight Credit Option

The second possible method of distributing the shortfall funds to producers would involve the establishment of a Producer Freight Credit Fund to be administered by the Western Grain Stabilization Administration.

IV.

- 17 -

This method would be developed and structured along the following lines:

- a) The amount of the railway revenue shortfall fund for each quarter section of land would be calculated in the same manner as that discussed for the direct payment method. The amount thus derived would be called a producer freight credit.
- b) The producer freight credit would be deposited in an account with the Western Grain Stabilization Administration. This credit would also be entered on a "new page" in the producer's Canadian Wheat Board delivery permit book.
- c) The freight credit account would be established each crop year commencing on August 1.
- d) When the producer makes a delivery of grain, the shipping company would initially pay the freight charges on the grain. The shipping company would regularly submit accumulated shipping charges to the Western Grain Stabilization Administration for settlement.
- e) When the Western Grain Stabilization Administration pays the shipping companies, it would make the appropriate deductions from the producer's freight credit account.
- f) When the producer has reduced his freight credit fund to zero prior to the end of a given crop year, he would then begin to pay the full freight charges on remaining deliveries of grain. If, on the other hand, the individual producer has a net balance in his freight credit account at the end of a particular crop year, the balance remaining would be paid directly to him.

It is proposed that the individual producer be given the choice of either the direct payment or the freight credit option. If he selected the first method, he would receive a direct payment at the beginning of the crop year and he would pay the full freight charges on the transportation of all of his grain as it was delivered. If he chose the freight credit approach, the transportation charges on his grain would be deducted from his freight credit account. Each producer would be free to choose the option which best suited his personal circumstances and type of farming.

It is strongly recommended that a special implementation task force be established to analyze in detail the mechanisms and administrative arrangements needed to implement the appropriate payment options. This task force should include, among others: representatives from the groups involved in the consultation process, the appropriate crop insurance agencies and the Western Grain Stabilization Administration.

IV. (4) Railway Costing

Because the statutory rates are not set in the transportation marketplace, the determination of the costs incurred by the railways is essential to the development of a reasoned and rational level of compensation to them for the transportation service they provide to grain which moves under the statutory rates.

To put in perspective the subsequent discussion of the development of the cost base which evolved from the consultation process, the first part of this section defines the basic components and categories of railway costs and describes their role in the development of reasonable and equitable compensation to the railways. The balance of the section describes the results of the consultation process regarding railway costing and the remaining differences in views between the railways and the shippers (the shippers being the producer organizations and the Canola Crushers).

a) Railway Costs - Definitions and Significance to the Process

Railway costs, like the costs of most industries, are comprised of four basic components; namely, labour, materials and supplies, taxes and capital. Of these, only capital costs require further description. In accounting and financial terms, capital costs consist of three elements - depreciation, return on investment, and an allowance for federal income taxes. Depreciation is the return of an industry's invested capital in proportion to the consumption of the assets purchased with that capital. The return on investment (termed the cost of capital by economists) is the risk-related rent paid to the debt holder and equity investor for the use of their funds while they are "tied up" in the assets of the company. The cost of capital also includes an allowance for the deterioration of the buying power of the invested assets and the dollar-return on those assets due to inflation. As the equity holder's portion of the return on investment is subject to federal income taxes, the return element also includes an allowance for such taxes.

b) Railway Cost Categories

Each of the components of railway costs identified above fall into one or more of three cost categories which reflect different characteristics of the railway industry's cost structure.

IV.

- 19 -

The volume-related variable cost category is the most significant category in terms of the proportion of the total costs incurred by the railways. The two distinguishing features of this cost category are that: (1) the costs contained therein vary directly with the volume of traffic carried, and (2) the costs can be traced to the particular traffic which causes them to be incurred through accepted railway cost-finding techniques.

The line-related variable costs are, for the most part, peculiar to the transportation of statutory grain. These costs result from the railways maintaining a network of some 6,900 miles of Prairie branch lines for the transportation of statutory grain traffic. The line-related costs are made up of the portion of maintenance costs, taxes other than federal income taxes, and capital costs related to the existence of the lines, rather than the volume of traffic carried on them. As these lines are continued in service because of the existence of the statutory grain traffic, the resultant line-related costs are caused by and directly attributable to that traffic.

Constant cost is a term used to describe the portion of the railways' total costs which remain after deduction of all costs which can be traced to particular traffic movements, (i.e. after deduction of the volume-related variable costs and the line-related variable costs). The constant costs are incurred on behalf of the system as a whole and are common to all traffic transported. For this reason, they cannot be allocated to specific traffic or attributed to the carriage of particular commodities.

c) Relevance of the Cost Categories to Railway Compensation for the Transportation of Statutory Grain

The volume-related variable costs and the line-related variable costs of the grain-dependent branch lines are caused by, and can be traced directly to, the transportation of statutory grain. If the compensation received by the railways is equal to the variable costs, the railways' financial position is neither harmed by the carriage of the grain traffic, nor is it helped. As each segment of traffic carried by the railways must produce revenues equal to its variable costs, the sum of the volume-related variable costs and line-related variable costs represents the minimum level of compensation that should be paid to the railways.

In contrast, the total system constant costs reflect costs incurred by the railways which cannot be traced or attributed to any particular traffic element. However, they must be covered by the revenues from all traffic combined if the railways are to obtain and maintain a position of financial viability. The compensation to cover the constant costs must be obtained from the charging of rates which exceed variable costs. The relevance of constant costs to the development of railway compensation levels extends only to the delineation of the total contribution over variable costs that must be obtained from all traffic combined.

d) Development of the Base Year Railway Compensation Level

The Federal Representative was charged with the responsibility of developing the railway revenue shortfall level for the 1981-82 base year period. By consensus, it was determined that this base year period should correspond to the crop year beginning August 1, 1981. Thus, it was necessary to develop the variable costs (volume- and line-related) and the contribution, if any, to be received by the railways, based on volume and cost levels applicable to the 1981-82 crop year.

The Federal Representative was not expected to develop the variable costs for the 1981-82 base year de novo. Rather, previous efforts and research on this matter, sponsored by the Federal Government, were used. The railways' variable costs were the subject of intensive study and analysis by the Commission on the Cost of Transporting Grain by Rail (Snaveley Commission) for calendar year 1974 and by Snaveley, King and Associates (SKA) for calendar years 1977 and 1980. These studies, and the reports and technical appendices which resulted therefrom, provided the Federal Representative with a starting point for consultation on this critical subject.

Despite the high level, state-of-the-art sophistication of railway costing in Canada, these reports clearly demonstrate that the costing process is in a continuous state of evolution and depends to some degree on subjective judgement. While there was a general consensus that the 1980 findings of Snaveley, King and Associates were a useful starting point for discussion, it was not surprising that submissions were made by the Pools, CN Rail and CP Rail which reflect different opinions and judgements. These differences, and the supporting rationale behind them, were the subject of considerable debate during the consultation process.

IV.

- 21 -

In developing the base year compensation level during the consultative process, there was concern with the quantification of five basic factors, namely:

1. The volume-related variable costs for calendar year 1980;
2. The grain-dependent line-related variable costs for calendar year 1980;
3. The additional volume-related variable costs, at the calendar year 1980 level, attributable to the new commodities placed under the statutory rates;
4. An appropriate level of contribution to constant costs for statutory grain traffic at the calendar year 1980 level; and
5. An appropriate methodology for indexing the calendar year 1980 variable costs and contribution to the base year 1981-82 level to reflect the impact of both changes in volume and cost increases.

In the discussion of each of these factors, a variety of methodological, conceptual, and judgemental positions were debated. The debates involved a diversity of topics, such as:

1. The cost of capital rates for compensatory rate-making for Federal Government subsidies, and for the specific risk associated with the transportation of statutory grain;
2. The Federal Government's intent concerning ownership of rehabilitated assets when it committed to the branch line rehabilitation program;
3. The proper method of quantifying the net value of the railway-funded assets in the grain-dependent lines;
4. The concept of normalized railway maintenance and its place in the development of line-related variable costs; and
5. A reasonable and equitable level of contribution to constant costs for the railways and the conditions under which the contribution would be paid.

e) Variable Costs - 1980

Table IV-2 shows a comparison of the variable costs as computed by the shippers and the railways for the year 1980. The differences in the two proposals are described below. The railways' 1980 variable costs (both volume-related and line-related) are identical to those calculated by SKA for 1980. This is consistent with their basic position that the only cost issue to be considered by the Federal Representative is the level of contribution to constant costs. The shippers' 1980 variable costs are the same as the 1980 SKA variable costs in all areas, except cost of capital, branch line assets purchased with rehabilitation funds and NAR/milling-in-transit. The cause of the differences between the shippers and the railways involved a number of factors which are discussed below.

1. Cost of Capital

The shippers have adopted 21.0% cost of capital as being the appropriate rate for grain transportation. This is the 1980 CTC-approved cost-of-capital rate for subsidy purposes. According to the CTC, this rate reflects the lesser business risk of subsidized traffic as compared to that of commercial freight which has a 1980 CTC-approved cost-of-capital rate of 24.35 per cent. The shippers advocate the use of the 21.0% rate as a reflection of the lower business risk they claim to be inherent in grain transportation.

The railways have adopted the SKA cost-of-capital rate of 25.4 per cent. This rate reflects SKA's estimate of a risk-related cost-of-capital rate for all freight traffic combined and is synonymous in concept (though not in its development) with the CTC-approved rate of 24.35% for commercial freight for the year 1980.

The dollar difference between the SKA cost-of-capital rate and the shippers proposed rate is \$19.9 million, plus an accompanying \$3.5 million reduction in NAR/milling-in-transit volume-related costs and a small per cent of the \$0.1 million reduction in NAR line-related costs.

11) Branch Line Rehabilitation Assets

This issue concerns the capital costs of the assets in the grain-dependent lines which were purchased with the Federal Government's branch line rehabilitation funds. There is no question that there are capital costs associated with these assets. The basic issue is whether such costs should be covered in the compensatory rates paid to the railways.

Table IV-2
COMPARISON OF VARIABLE COST PROPOSALS - 1980
(million dollars)

	<u>Shippers</u>	<u>Railways</u>
<u>VOLUME-RELATED</u>		
Costs at issue		
- cost of capital	\$ 63.1	\$ 76.3
- NAR/Milling-in-transit	12.3	15.8
- sub-total	75.4	92.1
Costs agreed to	343.8	343.8
Total	419.2	435.9
<u>LINE-RELATED</u>		
Costs at issue		
- cost of capital	\$ 32.1	\$ 38.8
- rehabilitated assets	0.0	9.9
- NAR	0.8	0.9
- sub-total	32.9	49.6
Costs agreed to	62.0	62.0
Total	94.9	111.6
TOTAL VARIABLE COSTS	\$ 514.1	\$ 547.5

IV.

- 24 -

As we understand this issue, it essentially involves a question as to the intent of the Federal Government in making the branch line rehabilitation funds available. This involves, in part, a legal interpretation of the source documents which can be used for determining such intent and questions as to the proper attribution of the capital costs on assets received as donations and grants. There also is a secondary issue of whether or not the dollars used to purchase these assets should be considered as revenues to the railways, if the capital cost of the assets are attributed to the railways.

f) Cost Increases to 1981-82

The railways have increased the costs and contributions from 1980 to 1981-82 on the basis of cost indices for five factors weighted according to the significance of each factor in the calculated volume-related and line-related costs for 1980. Table IV-3 shows a comparison of the base indices and weighting factors used by each railway. Overall the railways have increased the total costs between 1980 and crop year 1981-82 by an average 21.4% (CN) and 22.9% (CP) for inflation. This compares to the index of 15% (one and one-half years at 10% per year) used by the shippers.

The method used by CN and CP is clearly allied to the CTC-approved cost indices - the basis intended for use in determining future cost increases. The shippers' method is based on the 10% inflation factor used by the Federal Government to arrive at the original \$612 million figure, used for discussion purposes.

g) Contribution to Constant Costs

This is the most difficult task that was faced with respect to development of the railway revenue level. Unfortunately, the shippers and the railways are far apart on this issue in terms of concept and amount. In fact, the only common ground is that they both agree there should be a contribution at least over the ten-year period beginning with crop year 1982-83.

1. The Shippers' Position

The shippers have adopted the position that the contribution of statutory grain should be based on its share (e.g. 21% share of future traffic) of the new railway investment required during the next decade, not a contribution to current and ongoing constant costs as advocated by the railways. While not stated by the shippers, this approach logically would give the railways zero contribution if there were no expansion of the

Table IV-3

COMPARISON OF RAILWAY COST INCREASES, COST
FACTORS AND WEIGHTING OF FACTORS (1980 to 1981-82)

	<u>Volume-Related</u>		<u>Line-Related</u>	
	<u>CN</u>	<u>CP</u>	<u>CN</u>	<u>CP</u>
<u>COST INCREASE FACTORS 1981-82</u>				
Labour	1.217	1.222	1.217	1.222
Materials	1.219	1.216	1.219	1.216
Fuel	1.623	1.618	1.000	1.000
Depreciation	1.081	1.081	1.0575	1.081
Cost of Capital	1.143	1.145	1.081	1.145
Average	1.244	1.248	1.113	1.179
<u>WEIGHTING FACTORS</u>				
Labour	.379	.410	.458	.350
Materials	.297	.240	.141	.150
Fuel	.110	.120	.038	-
Depreciation	.035	.040	.349	.060
Cost of Capital	.179	.190	.014	.440

IV-3

plant and equipment (i.e., if all new investment were for the replacement of existing assets in kind) and would ultimately revert back to zero once the new investment required for expansion was amortized. The shippers proposed an average contribution to constant costs of \$88.1 million over the period 1982-1991. This would start at \$12.4 million and increase over the period.

11) The Railways' Position

The railways' proposal is based on a proposition that, under the ongoing viable railway concept, grain must make some contribution over variable costs independent of any changes in railway capacity. Because grain is a high-volume, long-haul, heavy-loading commodity, the railways believe that grain should produce a contribution greater than that of all freight combined because they normally expect greater-than-average contribution from the transportation of long-haul, high-volume, heavy-loading commodities. The railways' proposed contribution at the crop year 1981-82 level is \$188.4 million (\$92.4 million for CN and \$96 for CP). At the year 1980 level the railways proposed contribution amount is \$137 million (\$72 million for CN and \$65 million for CP). This is \$14 million greater than the SKA recommendations of \$123 million. Both railways have agreed to the proposition that these contribution amounts should be partially paid in the rate structure and partially subject to performance.

h) Resolution

The consultative process, while particularly well suited to resolution of differences based on judgements and evaluations of circumstances, does not and, indeed, cannot lead to conclusions which suggest that one position is "more correct" or "better" than another. Rather, it attempts to produce a negotiated consensus wherein the proponents of each position modify or change their original position or accept the position of another in a give and take process. To try to trace through the debates on each of the issues, and to delineate the basis in which each was resolved or left unresolved, would be a disservice to the participants in the process who, in the broader interests of arriving at a workable consensus, were willing to compromise highly supportable positions. It would also provide an unfair and biased view of the consultative process. Indeed, it is impossible to determine whether an agreement on one issue was the result of a "true meeting of the minds," or the result of a responsible trade of the acceptance of a specific position on one issue, for the acceptance of a specific position on another.

Although consensus has been reached on many aspects of rail costing, a number of costing issues remain unsolved. Recommendations for resolution are contained in Section V (3).

IV. (5) System Efficiency

The Federal Government Policy Statement of February 8, 1982, indicated that the new framework developed with respect to western grain transportation should promote increased efficiency and economy in the operation of the grain transportation system and the western railway system as a whole. System efficiencies were the subject of extensive discussions during the consultation meetings and the farm organizations and the railways agreed that there were significant opportunities within the total grain-handling and transportation system to promote increased efficiency and economy measures from the farm through to ports.

The potential savings resulting from increased efficiency and economy measures could prove extremely important in offsetting future cost increases in grain transportation.

Considerable progress has been made in the past few years. For example, rationalization has occurred in the elevator system. The number of country elevators reached a peak of 5,730 in the 1930's when over thirty companies had at least five elevators. This number has decreased to the present total of 3,201 and the number of operating companies with five or more elevators has declined to eight, all of which have twenty or more elevators. That rationalization process is continuing.

Other efficiencies have been achieved in other parts of the grain-handling system over the past decade. Particular examples include the introduction of the block-shipping system, car-pooling, car interchanges between railways, grain co-ordinators at the ports, and the provision of large-capacity hopper cars by the Canadian Wheat Board, the Federal Government, and the three Prairie provincial governments.

The railways have introduced efficiency measures within their own operations. Examples would include: increased train payloads through the use of larger cars and larger trains; increased train frequency through increased locomotive power, improved track structure, a centralized traffic control system, longer sidings and remote controlled lights, signalling and power switches.

During the discussions, many other potential efficiencies were identified throughout the entire grain-handling and transportation system. It was suggested that the Central Co-ordinating Agency, which is more fully discussed in a later section of this report, could co-ordinate and otherwise assist in helping to achieve the various efficiency measures suggested.

It is useful to outline a number of the potential efficiency and economy measures identified.

a) Changes to Physical Facilities

- 1) Both CP Rail and CN Rail indicated there appears room for considerable future savings through further rationalization of the branch line network. CP Rail has some 386.8 miles of branch line in the "unprotected" category, which represents a total potential saving of some \$6.7 million annually. CN Rail has approximately 600 miles of line in the "unprotected" category which, in turn, would represent potential savings of some \$11.4 million.

In addition to the reduction of the line costs, there would be further savings in maintenance and rehabilitation costs. Fewer cars would be required to service the reduced network because cycle times could be reduced. It was recognized that there may be some increased trucking costs if some "unprotected" branch lines are removed from the system. Some of the farm organizations indicated that the gains from these efficiency measures would not represent "net gains" if the costs were simply shifted from one part of the system to another.

- ii) Some participating organizations indicated that while the country elevator system had been rationalized over the last two decades, further rationalization could be considered where appropriate.
- iii) During discussions it was also pointed out that the grain industry could benefit through economies of scale associated with the operation of larger country elevators. The savings result from the loading of larger blocks of rail cars at one elevator spot, and the associated reductions in the amount of switching and time required to spot and pick up cars at a given point. Again, it was pointed out by some groups that these gains in efficiency should be true net gains, not an undue transfer of costs from one sector to another.
- iv) Continuing improvements in the car fleet by replacing aging box cars with hopper cars have produced savings in fuel, car repairs and switching, and the elimination of car cleaning and grain door costs. Hopper cars are significantly more efficient than box cars as they carry up to 40% more grain which results in less fuel consumption per tonne. Ease of loading and unloading is an associated factor.

CN Rail has estimated that savings due to the use of hopper cars could equal \$38 million annually by 1985-86, while CP Rail's estimate of annual savings is estimated at \$50 million by 1985-86.

- v) Modernization and expansion of existing terminal elevators through the installation of longer tracks and additional unloading facilities to accommodate hopper cars could be undertaken. The use of solid or unit trains could be promoted within these improved arrangements.

b) Changes to Operating Practices

- i) During the discussions, it was pointed out that the various participants in the grain-handling system operate within different work weeks. At present, the railways operate seven days a week while terminal country operations are on a five-or six-day week. It was suggested that the work week could be extended to seven days to maximize utilization of the rail car fleet and equipment and to minimize distortions in the transportation network. The present interruptions in the transportation flow, discourage maximum use of the system and tend to expand the length of car cycle times.
- ii) It was suggested by some participants that the extended use of reciprocal running rights and interchange agreements between CP Rail and CN Rail will facilitate the movement of grain. Such interchange agreements have been worked out on a short-term basis in the past and could be considered in the future.
- iii) The pooling of grains at terminal elevators, single-destination movements of grain (for example, all movements in a given week go one direction), and a reduction in cross hauls, could all produce significant savings in current operating practices. It was noted, however, that not all grains could be pooled and that, while single direction movements have been tried on a test basis, further studies would be needed on this possibility. It was estimated that reductions in cross haul alone could produce annual savings of up to \$30 million.

c) Improved Information and Planning

- i) Information and statistics on the performance of all elements in the grain-handling and transportation system are critical in designing attempts to further the effectiveness of this system. For example, precise forecasting of country car-loading requirements, as well as predicted arrival patterns at ports, are essential to the smooth functioning of the grain transportation system. Full information on the entire car cycle is required if meaningful efficiencies are to be effected.
- ii) Inadequate knowledge or assurances of vessel arrivals are seen as hampering effectiveness of both the Canadian Wheat Board and the Grain Transportation Co-ordinator. Less than adequate co-ordination between negotiation for car supply and expected movement from terminals contribute to inventory management problems.

IV.

- 30 -

- 111) Delays in vessel arrivals contribute to congestion at terminal elevators which backs up in the form of delays in unloading cars and on through the system back to the elevators and farms. It was suggested that a position desk at ports could be established to provide improved information on vessel arrivals and expected arrivals and vessel nominations tied to sales commitments, and to provide improved information to the car allocation process. It is acknowledged, of course, that many factors are involved in matching vessel arrival times with the grain-handling and transportation system with the result that there will always be a need to depend on inventory stocks or surge capacity at the ports to bridge some of the uncontrollable gaps in the system.

d) Summary

Many of the above-noted efficiency measures will lead to a significant reduction in a car cycle times. During the discussions it was pointed out that a one-day reduction in the car cycle could reduce the number of hopper cars required by about 1,000, which is equivalent to approximately \$73 million in investment.

A Central Co-ordinating Agency, as set out in a later section of the report, could be given the responsibility to administer, with a set of principles and guidelines, the performance and service guarantees to be undertaken by the railways and the efficiency and economy measures that could be undertaken in relationship to those service guarantees. Such an agency, with its associated committees, could provide the appropriate forum to discuss the efficiency measures that will be required if future cost savings are to be achieved.

IV. (6) Sharing of Future Cost Increases

One of the major objectives of the February 8 Policy Statement on Western Grain Transportation was to determine a fair sharing of future cost increases. Accordingly, the Policy Statement indicated that:

"Such an approach requires that all parties make a significant contribution. A fair sharing must be established, taking account of the capacity of each to absorb costs. The Government of Canada is prepared to commit \$1.35 billion to the Western Railway System, on top of previous commitments of \$1.85 billion, over the next four years -- a total of \$3.2 billion. The Government is asking the producers and the railways to consider the form and extent of their contributions."

The question relating to fair sharing of costs in western grain transportation has arisen because of several factors:

- (a) The fixed contribution by grain producers under the statutory grain rates.
- (b) The increases in volume of grain exports, particularly since the early 1970s.
- (c) The increases in rail transportation costs as a result of general inflation.

Up until the 1960s, it appears that the statutory grain rates, together with whatever gains could be derived from productivity increases in the overall grain handling and transportation system, were sufficient to cover most of the costs of transporting grain.

In recent years, however, it has become increasingly evident that the above factors have led to increasing losses on the transportation of grain and an overall deterioration in the grain rail system. All parties - the railways, the producers and the Federal Government - have shared, directly and indirectly, in these losses. Indeed, it has become clear that the larger the volume of grain moved, the larger the losses incurred by the railways and the Government.

Grain now represents approximately 20% of the railways' traffic load but provides only about 3.5% of the railways' revenue. The result has been that the railways have not only incurred losses on grain transportation but these losses have led to the neglect of the maintenance of the

current grain transportation system and to the deferment of investment in the expansion of the system to meet predictable increases in the volume of export grain.

On the surface, at least, it appears that the grain producers have been the beneficiaries of the fixed statutory rates for grain transportation. In 1974, it is estimated that the producers' shared contribution to the total costs incurred by the railways in the transportation of statutory grain amounted to approximately 36.3 percent. By 1980, the producers' share of these costs had dropped to 24.3% and by 1981/82, the proportion had declined still further to 18.6 percent. In the absence of any remedial action, it is anticipated that this share will drop even further to 12% in 1985 and to only 7% by 1990. But these benefits are deceiving. The producers, too, have incurred many indirect costs and disadvantages. The costs to producers of a deteriorating rail system (particularly evident during the decade of the 1970s), have been deferred export sales of grain, costly demurrage charges and increased storage costs on the farms. In addition, the statutory grain rates have led to an adverse impact on the canola-crushing and livestock industries on the Prairies.

The Federal Government has also had to share, in an extensive way, in the costs and losses associated with the present grain transportation system. Between 1974 and 1980, the Federal Government's share of the costs incurred by the railways in the transportation of statutory grain has increased from approximately 22 to 31.1 percent.

Since 1970, the Federal Government's expenditures on the grain transportation system have amounted to approximately \$1.8 billion. These expenditures have included: purchase of hopper cars, boxcar repair, branch line subsidies, branch line rehabilitation, developments at the Port of Churchill and Port of Prince Rupert, canola-crushing assistance programs, and an export flour subsidy through east coast ports.

Given this background of events, it is clear that a comprehensive approach to grain transportation in western Canada will be absolutely necessary for the future. The existing policies and programs are clearly inadequate. The ad hoc programs developed during the 1970s will simply not be satisfactory for the future.

If the comprehensive approach to grain transportation in western Canada is developed - and it is becoming increasingly clear that this is inevitable - the central question to be faced is this:

"How is a fair sharing of the costs to be established among the railways, the producers and the Federal Government taking account of the capacity of each to absorb these costs?"

IV.

- 33 -

These are difficult economic times for everyone. With slower economic activity and increased costs, no one alone is in a position to absorb large cost increases. Grain producers are in a very difficult economic position, with recent reductions in grain prices and rapidly increasing farm costs. It is estimated that, through this price-cost squeeze, farm income on the Prairies will decline substantially between 1981 and 1982.

Similarly, the railways are experiencing economic difficulties with reduced levels of traffic and much higher costs. CN Rail, for example, is forecast to have a net loss in 1982 versus a profit in 1981.

The Government of Canada is not in a position to raise its contribution to grain transportation costs extensively. It has already committed \$3.2 billion from 1982-83 to 1985-86 and the "Crow benefit" in perpetuity. A significantly larger contribution will be difficult given lower tax revenues, increased expenditures and high deficits.

Hence, determining a fair sharing of future costs among the three parties, all faced with limited resources, is not a simple task. It requires, at a minimum, the acceptance of three criteria: pursuit of every opportunity to keep costs down; recognition that there has to be a phasing in of any transfer of future costs from one party to another; and the capacity of each to absorb cost increases. All three criteria were analyzed in the consultation process and used as the basis for arriving at the greatest degree of consensus as outlined in this report.

It is important to refer to the five major factors that determine future costs of grain transportation and the sharing of these costs: First, it is important to decide on a reasonable level of current grain transportation cost estimates on which future cost increases will be based. If the costs are set too high for 1981-82, farmers and government may be paying more than necessary now and in the future to the railways to move grain. Alternatively, if current cost levels are set too low, the railways may be forced to absorb costs that should logically be paid now and in the future by others.

Second, productivity and efficiency measures can play a major role in keeping costs down. The grain transportation and handling system has achieved limited productivity gains over the past few years. Any sharing of future cost increases must keep in mind that, those who absorb the costs should be given the opportunity to benefit from any productivity gains. Of course, the benefits of productivity gains can be shared by all participants in the grain-handling and transportation system.

Third, the Government has, historically, absorbed a larger and increasing share of the costs of grain transportation through various

IV.

- 34 -

special programs, such as branch line subsidies, hopper car purchases and leases, and the branch line rehabilitation program. These programs have reduced the costs for farmers and the net losses for the railways. The Government has indicated that while, in principle, it is prepared to continue some of these programs for a few more years, they should be terminated in the not-too-distant future. As this happens, other, presumably the railways and/or producers, will have to assume some of the future responsibilities and costs.

Fourth, increasing volumes of grain shipments add to future costs. The Canadian Wheat Board projections of grain exports of 36 million metric tonnes by 1990 will presumably add over 30% to the grain transportation bill. Most of the benefits of these increased volumes accrue to the producers and, hence, they could be expected to absorb most or all of these costs. Yet the Government benefits from a stronger economy, a better balance of payments, a stronger dollar and higher tax revenue. The railways benefit through better utilization of plant and equipment and economies of scale.

Finally, inflation is expected to play a major role in future cost increases. Currently, inflation is running at about 12% in the Canadian economy, and as some participants in the consultation process stated, if this continues, no one can afford to remain in farming. Therefore, it is certainly hoped that inflation will moderate in the near future. However, current forecasts by the railways and the Canadian Transport Commission for inflation in grain transportation show annual increases of about 12% from 1982 to 1985, and 10% thereafter. At these levels, producers have argued that they simply will not willingly accept any change in statutory rates unless the Government shares extensively in picking up future costs of inflation.

The effects of inflation on the fixed statutory rate for the transportation of grain, as a proportion of farm price, may be noted in Table IV-4. In 1971-72, the statutory rate per tonne as a share of the price of wheat, amounted to 10.3%; this share had dropped to 2.5% by 1980-81. There is little doubt that the fixed statutory rate, relative to the price of wheat, has declined sharply during the past decade.

At the same time, it must be noted that inflation has had an adverse impact on the farmers' income position in western Canada. In 1970-71, one of the more distressing years in Prairie agriculture, the deflated average price received per tonne of wheat amounted to \$48.18 (Table IV-5). It is important to note that the deflated price of wheat was only moderately better during 1980-81. Only during the years 1973-74 and 1974-75 did producers receive exceptionally high prices for their grain; grain prices during this period ranged from 30 to 60% higher than current prices.

IV.
- 35 -

Table IV-4

WHEAT PRICES AND FREIGHT RATES

Farm Level Prairie
Wheat Prices

Freight From
Scott, Saskatchewan

	Actual Price	Price Restated, in 1971 Dollars	Actual Rate	Rate Restated, in 1971 Dollars	Freight as a Share of Price
			- dollars per tonne -		percent
1930 - 31	17	59	5.07	17.30	29.3
31 - 32	14	51	5.07	19.13	37.0
32 - 33	12	50	5.07	20.20	40.4
33 - 34	17	69	5.07	20.28	29.5
34 - 35	22	86	5.07	19.88	22.9
35 - 36	22	85	5.07	19.65	22.8
36 - 37	34	127	5.07	18.99	15.0
37 - 38	38	139	5.07	18.64	13.4
38 - 39	21	80	5.07	18.99	23.6
39 - 40	19	71	5.07	18.50	25.8
40 - 41	21	73	5.07	17.73	24.2
41 - 42	22	67	5.07	15.75	23.4
42 - 43	28	79	5.07	14.40	18.1
43 - 44	42	111	5.07	13.56	12.2
44 - 45	46	117	5.07	12.97	11.1
45 - 46	60	150	5.07	12.64	8.4
46 - 47	60	140	5.07	11.90	8.5
47 - 48	60	123	5.07	10.45	8.5
48 - 49	60	114	5.07	9.68	8.5
49 - 50	59	110	5.07	9.46	8.6
50 - 51	56	96	5.07	8.71	9.1
51 - 52	56	90	5.07	8.13	9.0
52 - 53	58	92	5.07	8.06	8.7
53 - 54	48	77	5.07	8.09	10.4
54 - 55	45	73	5.07	8.15	11.2
55 - 56	50	79	5.07	8.00	10.1
56 - 57	46	69	5.07	7.68	11.1
57 - 58	47	69	5.07	7.49	10.8
58 - 59	48	70	5.07	7.29	10.4
59 - 60	48	67	5.07	7.07	10.5
60 - 61	58	78	5.07	6.89	8.8
61 - 62	64	84	5.07	6.67	7.9
62 - 63	61	76	5.07	6.31	8.3
63 - 64	64	79	5.07	6.24	7.9
64 - 65	58	71	5.07	6.15	8.7
65 - 66	62	72	5.07	5.88	8.2
66 - 67	65	73	5.07	5.70	7.8
67 - 68	60	65	5.07	5.58	8.5
68 - 69	49	52	5.07	5.38	10.4
69 - 70	46	48	5.07	5.28	11.0
70 - 71	52	53	5.07	5.18	9.7
71 - 72	49	48	5.07	4.92	10.3
72 - 73	69	60	5.07	4.46	7.4
73 - 74	165	121	5.07	3.74	3.1
74 - 75	155	101	5.07	3.31	3.3
75 - 76	133	78	5.07	2.96	3.8
76 - 77	105	60	5.07	2.89	4.8
77 - 78	103	55	5.07	2.68	4.9
78 - 79	139	63	5.07	2.28	3.6
79 - 80	178	72	5.07	2.04	2.9
80 - 81	206	74	5.07	1.82	2.5

* Prices and rates restated by dividing by the Farm Input Index for Western Canada (1971 = 100) for the crop year.

Sources: Canada Grains Council, Outlook '82
Canada Grains Council, Unpublished table comparing prices and freight rates
Statistics Canada, Unpublished data.

TV

- 36 -

TABLE IV-5

ACTUAL AND DEFLATED AVERAGE PRICE RECEIVED FOR WHEAT,
PRAIRIE PROVINCES, 1930-31 TO 1980-81

Year	Average Price Received Per Tonne	Farm Input Price Index, Western Canada	Deflated Average Price Received Per Tonne
	dollars	1971-100	dollars
1930-31	17.27	29.3	58.94
1931-32	13.60	26.5	51.32
1932-33	12.49	25.1	49.76
1933-34	17.27	25.0	69.08
1934-35	22.05	25.5	86.47
1935-36	22.05	25.8	85.47
1936-37	33.80	26.7	126.59
1937-38	37.85	27.2	139.15
1938-39	21.31	26.7	79.81
1939-40	19.47	27.4	71.06
1940-41	20.94	28.6	73.22
1941-42	21.68	32.2	67.33
1942-43	27.93	35.2	79.35
1943-44	41.52	37.4	111.02
1944-45	45.93	39.1	117.47
1945-46	60.26	40.1	150.27
1946-47	59.52	42.6	139.72
1947-48	59.89	48.5	123.48
1948-49	59.89	52.4	114.29
1949-50	58.79	53.6	109.68
1950-51	55.85	58.2	95.96
1951-52	56.22	62.4	90.10
1952-53	58.06	62.9	92.31
1953-54	48.50	62.7	77.35
1954-55	45.19	62.2	72.65
1955-56	50.34	63.4	79.40
1956-57	45.56	66.0	69.03
1957-58	47.03	67.7	69.47
1958-59	48.50	69.5	69.78
1959-60	48.13	71.7	67.13
1960-61	57.69	73.6	78.38
1961-62	63.93	76.0	84.12
1962-63	60.99	80.3	75.95
1963-64	63.93	81.3	78.63
1964-65	58.42	82.4	70.90
1965-66	61.73	86.2	71.61
1966-67	64.67	89.0	72.66
1967-68	59.52	90.9	65.48
1968-69	48.87	94.3	51.82
1969-70	46.30	96.1	48.18
1970-71	52.18	97.9	53.30
1971-72	49.24	103.1	47.76
1972-73	68.71	113.7	60.43
1973-74	164.61	135.5	121.48
1974-75	154.69	153.3	100.91
1975-76	133.01	171.0	77.76
1976-77	105.45	175.7	60.02
1977-78	103.29	189.5	54.51
1978-79	139.15	222.2	62.62
1979-80	178.00	248.3	72.00
1980-81	206.00	278.5	74.00

Source: Statistics Canada
From Canada Grains Council Outlook '82

IV.

- 37 -

What can be anticipated by way of future inflationary increases is difficult to estimate. Some indication of the impact of varying rates of inflation on grain transportation costs may be noted in Table IV-6. For the purposes of illustration only, it is assumed that the total cost of grain transportation during 1980-1981 amounted to \$750 million. At a 3% rate of inflation, these costs increased to \$1.038 billion by 1991-92. At an 8% inflation rate, the total increased to \$1.749 billion.

The total railway revenue requirement for grain transportation at varying rates of inflation is illustrated in Figure IV-1.

It is clear that inflation rates must be controlled, productivity of the grain transportation system greatly accelerated, or grain prices sharply increased, if grain transportation rates are to be kept within manageable limits during the next decade. A continuing inflation rate of 10 or 12% per annum could have a devastating impact on the grain transportation system in western Canada. Several of the farm organizations involved in the consultation process made it clear that farmers must be protected against this broad and unusual exposure to inflation. To cope with the 12% inflation rate, the price of wheat would have to rise to approximately \$20.00 per bushel by the end of the decade, a not very likely outcome.

While a more detailed analysis will be made of cost sharing in Chapter V of this report, the data in Table IV-4 provide a simple illustration of what happens when grain producers assume different shares of a projected inflation rate of 8 percent. If the producers assume 3% of the inflation increase and continue to pay the current statutory rate, their share of the total transportation costs would rise to a peak of 25.3% in 1989-90 and would decline gradually thereafter.

On the other hand, if producers assumed an inflation increase up to 5% (assuming an overall inflation rate of 8%), their share of total transportation costs would rise to 39.9% by 1991-92 (Table IV-7).

It is clear that the producers' share of total transportation costs has declined significantly during the past decade, and it does not seem unreasonable that they should assume a somewhat larger share in the future.

However, the increasing share must somehow be related to the producers' capacity to absorb these increased costs. Perhaps, the best way of measuring the capacity to absorb future cost increases in transportation would be to relate transportation costs to the prevailing price of wheat.

The data in Table IV-8 illustrate one method that could be used in relating freight rates to the producers' capacity to pay.

IV.

- 38 -

It is assumed, for this example, that the level of wheat prices during the period 1982-83 to 1991-92 follows the same general trend as it did in the previous decade but at a lower assumed rate of inflation. The variability in wheat prices for 1982-83 to 1991-92 is assumed to be similar to that for the decade of the 1970's.

For the purpose of illustration only, a set of freight rates is also calculated for the grain producer for the period 1982-83 to 1991-92 (Table IV-8).

In order to provide the farmer with some sort of "safety net" during years in which wheat prices drop significantly relative to his freight rates, a maximum freight rate could be set by relating the maximum rate to his price of wheat. For example, if the maximum freight rate (the "safety net") was set at 6% of the price of wheat, the farmers would pay only the maximum rate (not the schedule rates) during 1986-87, 1987-88 and 1991-92 when the assumed wheat prices declined significantly.

Figure IV-2 shows the farmers' calculated freight rates outlined in Table IV-8 and the effect of maximum rates set at 6% and 4% of the prevailing price of wheat.

Of course, in those years when the calculated freight rates exceeded the maximum rate limits set, a deficit would be created. For example, the maximum rate of 5% would create an aggregate deficit of \$18.95 per tonne over the ten-year period or an average of \$1.90 on an annual basis (see Table IV-8).

To handle the deficits created by setting maximum rate limits, a "Grain Freight Rate Stabilization Fund" could be set up for that purpose. With the 5% maximum limit set in Table IV-8, the payout from the fund would have amounted to \$2.83 per tonne in 1986-87. The payout would have been \$7.36 per tonne in 1991-92. If the fund is to be self-sustaining over a longer run period of time, the periodic payouts would have to be offset by some type of annual levy. In the case of the 5% maximum limit, the annual levy would have to be \$1.90 per tonne or 5.2¢ per bushel. It should be noted that the lower the maximum rate limit, the higher the annual levy needed by the fund. In the case of a 4% maximum limit, for example, the annual levy required would be \$4.14 per tonne or 11.3¢ per bushel.

There are many different ways in which the proposed Grain Freight Rate Stabilization Fund could be established. If such a fund were developed, it could be operated under the existing W.G.S.A. The required annual levies could be collected in a manner and in the same proportion as that now in effect for the W.G.S.A., i.e., one-third from the producers and two-thirds from the Federal Government.

IV.

- 39 -

Depending on the maximum rate limits set, calculations indicate that the required annual contribution to the Fund would not be too onerous to any of the parties involved. In part, some of the contribution to this Fund could come from the unspent "Crow benefit", when volumes drop below the 1961-62 base volume.

The major benefit of this plan is that the scheduled freight rates could be increased to a level where the producer could be expected to carry a somewhat larger share of the total transportation costs without exacerbating the effects of large and unexpected fluctuations in his grain prices. In other words, freight rates could be kept within predictable limits of the producers' capacity to absorb such costs. In years in which the price of grain dropped drastically relative to the scheduled freight rates, the producers' freight payments would not exceed some known limit.

In concluding this section of the report, it must be pointed out that during the consultation process, the producer group did not agree to share more than one-half of the inflation rate up to a maximum of 3 percent. (i.e., $\frac{1}{2}$ of a total inflation rate of 6 percent). Indeed, one of the organizations indicated that it could not agree to the sharing of any future cost increases until other conditions relating to overall grain transportation policy had been resolved. Other organizations agreed to share future cost increases up to some limit, providing that provisions were made to achieve as much savings as possible through efficiency and economy gains in the system. In general, the producer group took the position that there was a limit beyond which they could not agree to go in sharing the increased costs due to inflation; firstly, because of economic conditions within the agricultural industry and, secondly, because the broader inflation problem had to be solved by national monetary and fiscal policies, not through grain transportation policy.

While the possibility of establishing some form of maximum rate limit, based on the prevailing price of grain, was discussed during the consultation process, no conclusions were reached on this topic. In fact, many organizations felt that the grain price instability problem could best be handled through the existing Western Grain Stabilization Program.

IV.

- 40 -

Table IV-6

TOTAL RAILWAY REVENUE REQUIREMENTS WITH
INFLATION RATE AT VARYING LEVELS

Year	3%	6%	8%	10%	12%
			- \$ millions -		
1981-82*	772	795	810	825	840
1982-83	795	843	875	908	941
1983-84	819	893	945	998	1054
1984-85	844	947	1020	1098	1180
1985-86	869	1004	1102	1208	1322
1986-87	895	1064	1190	1329	1480
1987-88	922	1128	1286	1462	1658
1988-89	950	1195	1388	1608	1857
1989-90	978	1268	1499	1768	2080
1990-91	1007	1343	1619	1946	2330
1991-92	1038	1424	1749	2140	2609

* Assumes in 1980-81 a total railway revenue requirement of \$750 million, of which \$150 million would be provided from the current statutory rate applied to approximately 30 million tonnes of grain. The data included in this table have been greatly simplified for illustrative purposes. Precise and detailed data, relating to railway revenue requirements and other associated factors, are outlined and discussed in Chapter V of this report.

Figure IV-1
TOTAL RAILWAY REVENUE REQUIREMENTS WITH
INFLATION RATE AT VARYING LEVELS

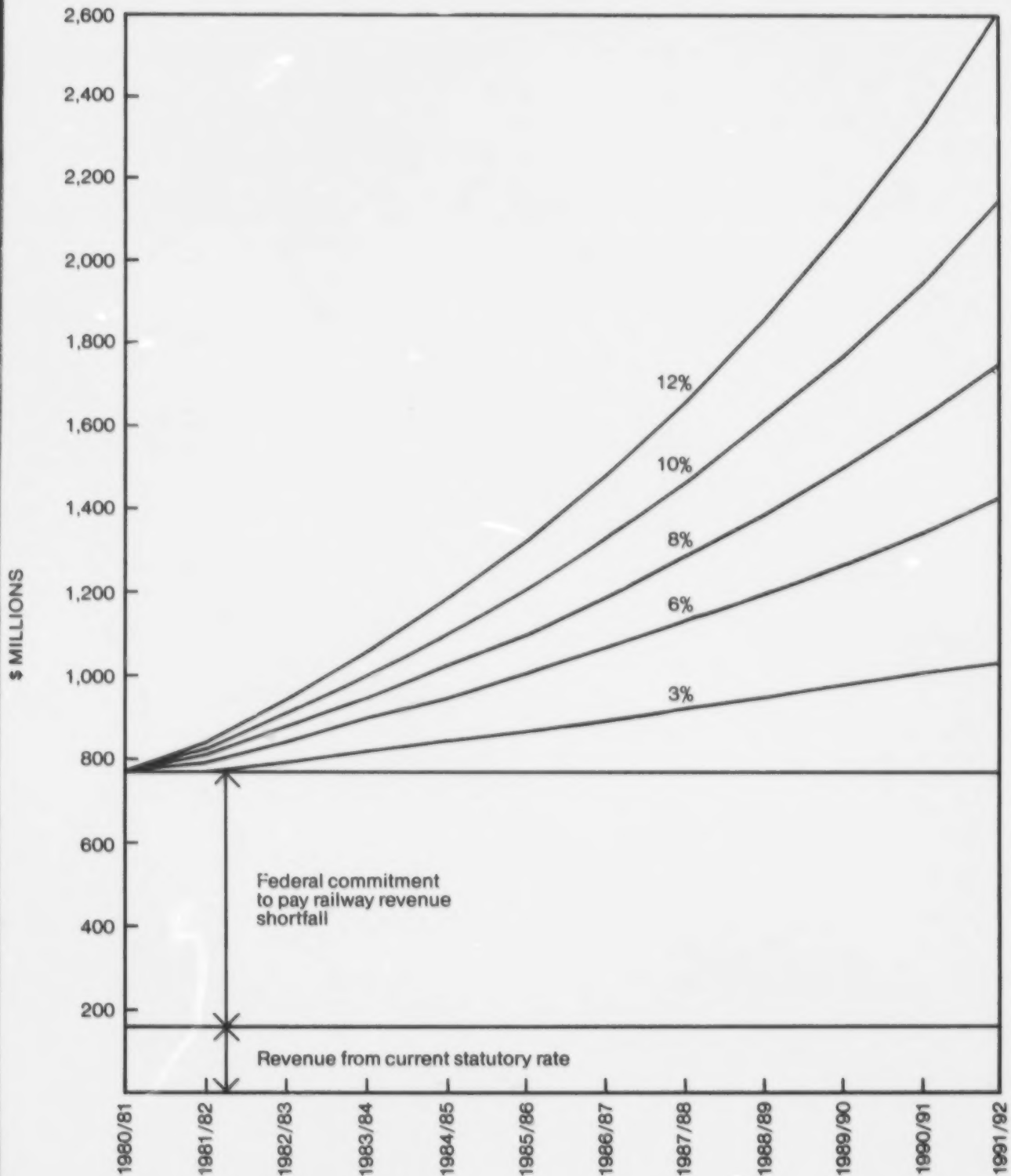


Table IV-7

SHARES OF TOTAL RAILWAY REVENUE REQUIREMENTS ASSUMING AN
8% INFLATION RATE AND VARYING CONTRIBUTIONS BY PRODUCERS

Year	Total Railway Requirement	Current Statutory Rate		Producers Share Up To 3% Of Inflation Increase and Pay the Statutory Rate		Producers Share Up To 5% of Inflation Increase and Pay the Statutory Rate	
		Amt.	% of Total	Total Paid By Producers	% of Total	Total Paid By Producers	% of Total
	\$ Million	\$ Million		\$ Million			
1981-82*	810	150	18.5	172	21.2	188	23.2
1982-83	874	150	17.2	196	22.4	227	25.9
1983-84	945	150	15.8	220	23.2	268	28.3
1984-85	1020	150	14.7	244	23.9	312	30.6
1985-86	1102	150	13.6	269	24.4	357	32.4
1986-87	1190	150	12.6	296	24.6	405	34.0
1987-88	1286	150	11.6	322	25.0	455	35.3
1988-89	1388	150	10.8	350	25.2	508	36.6
1989-90	1499	150	10.0	379	25.3	563	37.5
1990-91	1619	150	8.9	408	25.2	622	38.4
1991-92	1749	150	8.5	438	25.0	682	38.9

* Assumes total railway revenue requirement of \$750 million in 1980-81 and an 8% inflation rate; the current statutory rate yields a total revenue of approximately \$150 million based on approximately 30 million tonnes of grain.

Table IV-8

EXAMPLE OF CALCULATED FREIGHT RATES
AS A PERCENT OF WHEAT PRICES

Year	Assumed Farm Level Wheat Price ^a	Calculated Freight Rates/Tonne ^b	Rate Maximum as Percent of Price of Wheat		
			6%	5%	4%
				per tonne	
1982-83	\$200	\$ 11.99	12.00	10.00	8.00
1983-84	436	13.03	26.16	21.80	17.44
1984-85	393	13.96	23.58	19.65	15.72
1985-86	328	14.72	19.68	16.40	13.12
1986-87	267	16.18	16.02	13.35	10.68
1987-88	260	17.16	15.60	13.00	10.40
1988-89	315	18.18	18.90	15.75	12.60
1989-90	382	19.28	22.92	19.10	15.28
1990-91	416	20.43	24.96	20.80	16.64
1991-92	286	21.66	17.16	14.30	11.44
Total Payout Over 10 Years ^c			\$6.22	\$18.95	\$41.44
Levy Required Per Tonne ^d			62¢	\$ 1.90	\$ 4.14
Levy Required Per Bushel			1.7¢	5.2¢	11.3¢

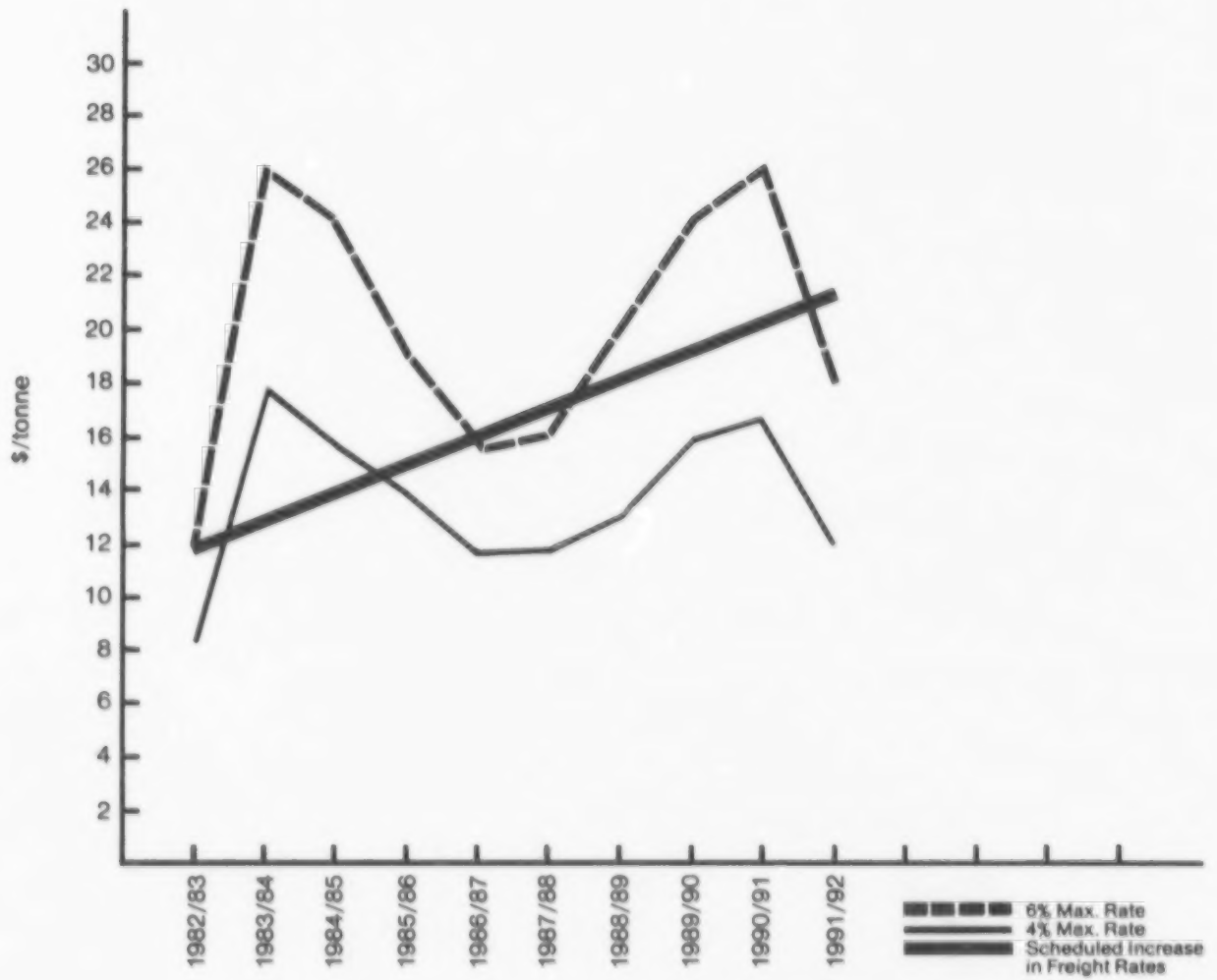
a Price of wheat assumed to increase generally in line with a moderate projected increase in the farm input price index and the variability to be similar to that in the decade of the 1970's.

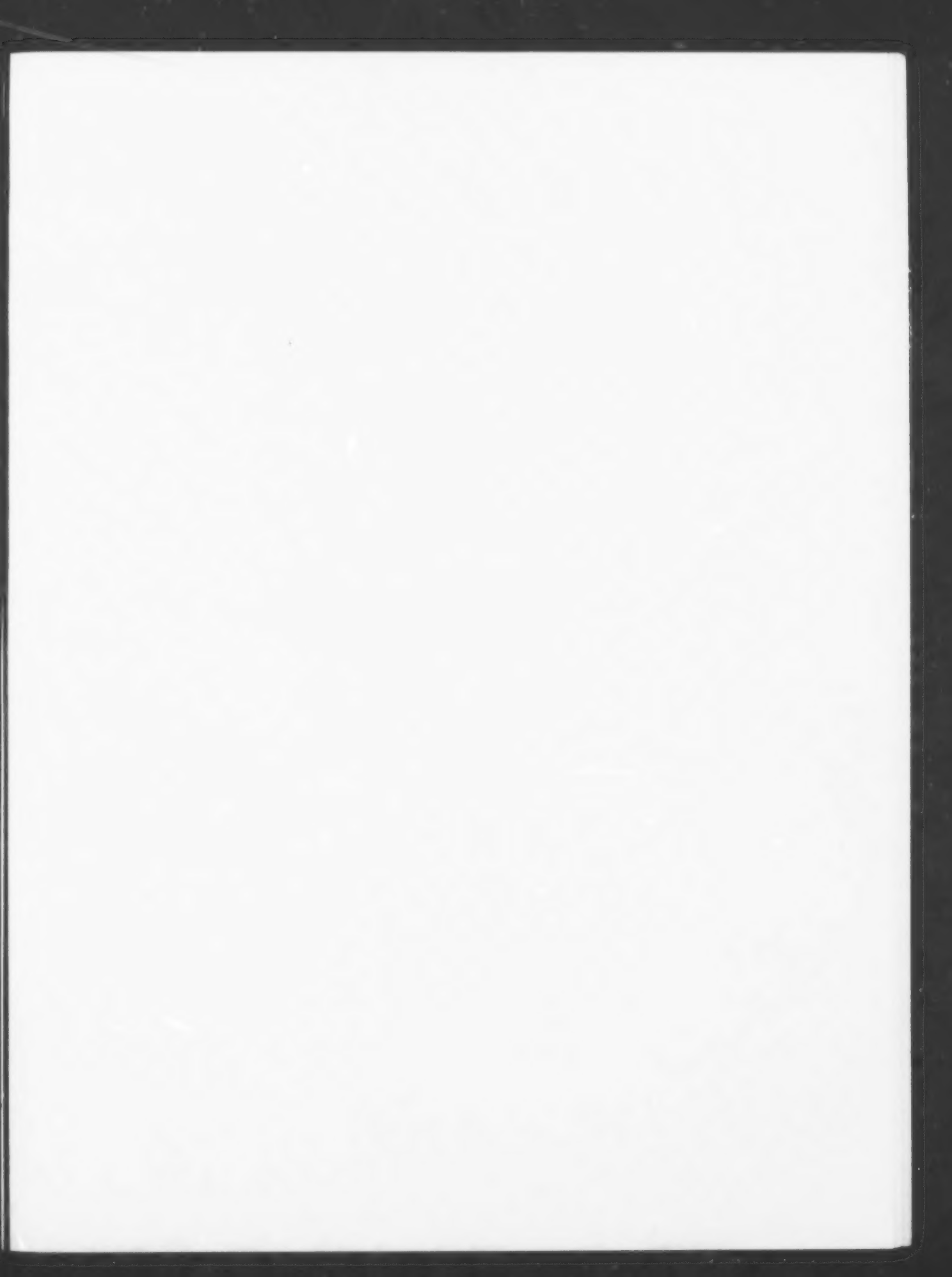
b Calculated on the basis of estimated changes in total freight costs.

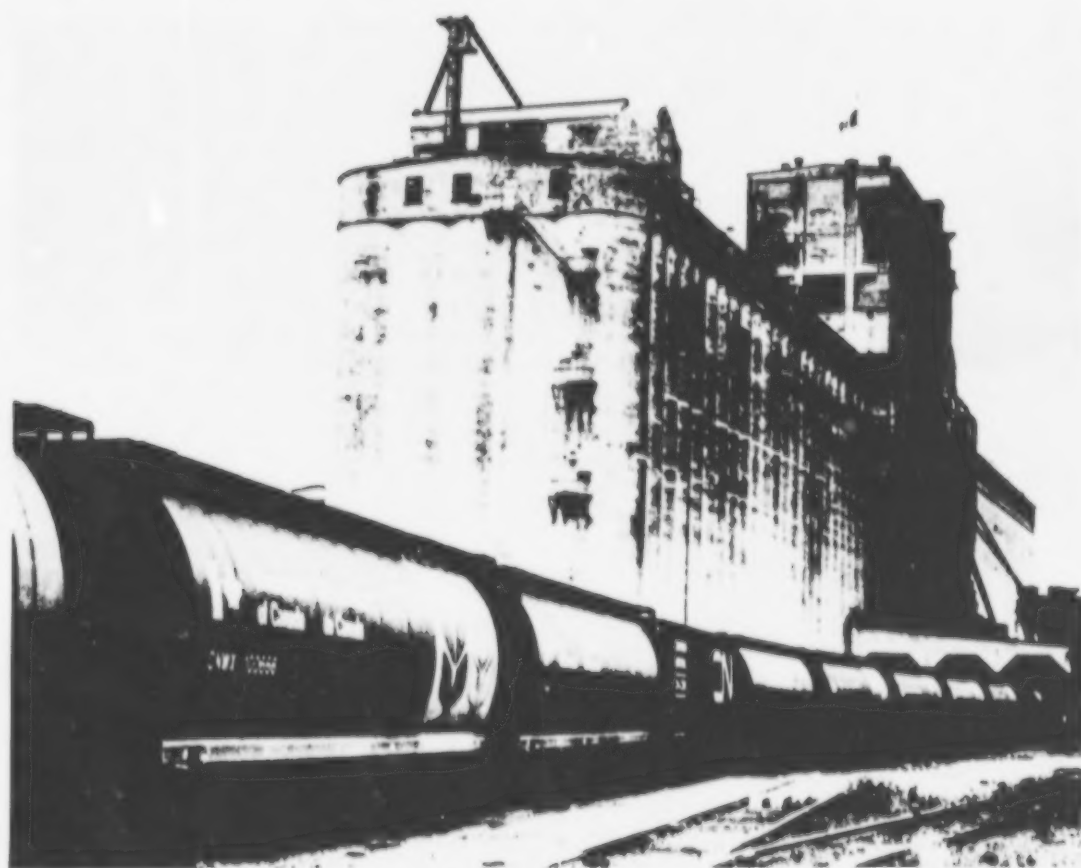
c The sum of the per-tonne payouts for those years when the calculated rate exceeds set rate maxima.

d Rate required to be collected on constant volume each year in order to fund difference between the calculated rate and the various maxima.

FIGURE IV-2
EXAMPLE OF CALCULATED FREIGHT RATES
AS A PERCENTAGE OF WHEAT PRICES







V. THE COMPREHENSIVE APPROACH TO THE SOLUTION

If there was one overriding concern in the consultation process, it was that the piece-meal and ad hoc approach to western grain transportation issues was simply not an effective or a lasting way of coping with the enormous problems beginning to emerge in the grain transportation system. All participants agreed that the resolution of these problems had to be developed within a comprehensive framework; that the remedies for the railway problem had to be found within the context of an overall policy for the western grain transportation system. This is the approach which has been followed in the analysis of the issues and the resulting recommendations offered in this section of the report.

V. (1) The Search for Common Ground

As we have outlined in previous sections of this report, the initial positions taken and recommendations made on the many items relating to grain transportation in western Canada varied considerably among the organizations. The major topics of concern to all organizations which submitted written briefs to the Federal Representative and which were the focal point for intensive discussion throughout the consultation process included: determination of railway costs and the size of the railway revenue shortfall; revenue sources available to the railways; federal capital contributions to the railway system; methods of disbursing the fixed federal contribution to the estimated railway revenue shortfall in 1981-82; sharing of future cost increases; performance and service guarantees; efficiency measures; distortions among the various commodity rates; and elements of the new statutory and legislative framework.

On some of these items there appeared to be general agreement among all of the organizations. On a number of issues, there were almost identical positions taken by some of the organizations. On still other issues, there were significant differences of opinion and points of view expressed within the group.

That there were differences in points of view brought to the early discussions is not surprising. The participants involved in the consultation process were selected specifically because they represented the wide diversity of interest groups and concerns associated with the western agricultural industry and the grain handling and transportation system. In the final analysis, it is within the highly

diverse economic and institutional framework that answers must be found and policies developed for the grain transportation system in western Canada.

But these differences should not obscure the many fundamental interests and points of view shared by the group. No one was compelled to participate in the discussions. The participants came together voluntarily. They were bound together in the consultation process by the common recognition that there were serious problems associated with grain transportation in western Canada and that a comprehensive, long run solution was required if the full potential of western Canadian agriculture was to be realized.

It was the mutual desire for a comprehensive grain transportation policy which led to a genuine search for common ground throughout the consultation process. A substantial measure of agreement was achieved on a large number of items as a result of a clearer understanding of the basic issues involved and a willingness to explore and assess all possible alternatives. It became evident that there were many areas in which mutually acceptable approaches could be taken.

On some matters the mutually acceptable solution was not easy to reach. At times it was difficult to reach obvious compromises that would at the same time be reasonably consistent with earlier policy positions developed by the respective delegate bodies and organizational constituencies. In some instances, unanimous agreement was not possible. In other cases, where complete consensus was not achievable, but where some proposition or alternative appeared to have merit, the groups concerned indicated that they would be prepared to take the results of the discussion back to their respective constituencies for further examination and debate.

There were a few items, of course, on which fundamental and understandable differences remained at the end of the consultation process. An explanation of these differences and the reasons for the final recommendations are outlined in following sections.

It is important to emphasize that the search for common ground was evident throughout the consultation process. That mutual understanding and considerable agreement were eventually found on so many basic issues is a reflection of the frank discussion and the open-minded approach taken by all participants. Even where differences remained, the reasons for the lack of agreement were generally understood by all concerned.

It would be presumptuous to think that complete consensus was possible on every aspect of a topic as diverse, complex and far-reaching in its implications as western grain transportation. But what is important is that the results of the consultation process have provided the general basis for a comprehensive approach to the western grain transportation issue.

The results and recommendations outlined below attempt to reflect the consensus where it existed, and the concerns of the participants whose contributions during the consultation process helped to shape the overall framework for grain transportation policy in western Canada.

The participants involved possessed the necessary skill, experience and pragmatism to tackle the many difficult and contentious issues in a constructive and creative way. We hope that the policy and legislation which will eventually be developed for western grain transportation can be developed in a way that will command the understanding and support of the many groups and constituencies represented by their leaders who were involved in the consultation process.

The consultation process which was initiated on February 8, 1982, was the result of the groundwork laid during the previous decade by leaders and policy makers who had participated in seemingly endless special studies, enquiries and commissions and who finally decided that the time had come to find a comprehensive and lasting solution to western grain transportation problems. The consultation process has provided a unique opportunity to find that solution.

V. (2) The Comprehensive Approach

The predominant approach to western grain transportation problems during the 1960s and 1970s can generally be described as "piece-meal" and ad hoc in nature. A number of special measures were taken to cope with particular and isolated issues. Railway losses were dealt with through a series of ad hoc programs, financed mainly by the Federal Government. These programs included such actions as the branch line subsidy program, the branch line rehabilitation program and hopper car purchases. Distortions arising from the statutory rates were handled by such special measures as the program to reimburse canola processors for part of the difference between minimum compensatory freight rates for canola oil and meal and the statutory rate which was in effect for the raw canola and meal to Thunder Bay. Capacity and performance problems within the grain handling and transportation system were handled through a number of special measures and programs such as the establishment of the block shipping system, repair of boxcars and car pooling. Many other such ad hoc emergency measures could be cited as examples of the general approach taken during the past 10 or 20 years to cope with problems and issues relating to the western grain transportation system.

It would be unfair, of course, to criticize any particular program or special measure undertaken at any given time. These special measures were instituted at a particular time to deal with immediate and urgent problems. Indeed, some of these special programs not only met a particular problem under a given set of circumstances but experience has shown that such programs should be continued as an integral part of any long-term policy for the industry.

But the general fact remains that several of these special ad hoc programs are not an effective and lasting cure for the problems of the grain transportation system. And, what is just as important, the climate of uncertainty created by this piece-meal approach to the system as a whole has had a detrimental effect on future planning and investment decisions for the many sectors and organizations involved in grain transportation.

It was this background of events of the last two decades that led many in the grain handling and transportation system to conclude that a more comprehensive approach was needed to deal with the emerging problems in the industry. Certainly, this was the major objective of the policy statement issued by the Federal Government on February 8, 1982, and it was the approach taken by the participants in the consultation process.

The analysis which follows is based on a comprehensive approach to the problems of the western grain transportation system. While the railway revenue shortfall problem was an important part of the analysis, it has been considered as an integral part of a set of other related issues. Railway performance and service guarantees, likewise, have many other implications besides simply ensuring that the railways perform effectively. And the method of payment problem has many important dimensions besides simply deciding whether to pay the railways or pay the producers.

What follows is, in effect, a step by step description of a "package" of highly interrelated issues and problems. The recommendations have been designed to provide a comprehensive approach to the solution of the many questions which have been raised with respect to western grain transportation. The recommendations are necessarily provided on an issues basis, but relate one to another as parts of a totality.

The development of a comprehensive solution that will be fair, effective and realistic (in transforming the grain handling and transportation system) should contribute to achievement of the following:

- i) the creation of an environment conducive to an efficient and responsive grain handling and transportation system;
- ii) permit and support healthy development of Western Canadian agriculture by providing efficient transportation in a manner which is neutral with respect to resource use in agriculture and does not favour one kind of production over others;
- iii) minimizing the negative impact of transportation and associated costs on grain producers;
- iv) resolving the revenue shortfall problem facing the transportation system;
- v) be simple to administer and understand;
- vi) minimizing and rendering manageable the financial requirements on government relative to results;
- vii) be politically acceptable to all those affected; and
- viii) result in a system that will not be vulnerable to future political change.

V. (3) The Cost of the Solution

The resolution of western grain transportation problems requires a comprehensive approach rather than a series of "ad hoc" pieces. The purpose of this section is to specifically lay out the assumptions of the comprehensive approach and to place a cost on the package.

The elements of the package are based on the "shippers' proposal" with subsequent modification and refinement. It should be noted that not all elements of the original proposal were endorsed by all organizations in the consultation process. Not all of the issues were resolved during the formal consultations; consequently, this section contains recommendations for dealing with the unresolved issues. The elements considered below include volume of grain shipments, railway revenue shortfall, Federal Government capital program, and sharing of future cost increases.

a) Volume of Grain Shipments

The estimated volume of grain shipments to be used in calculating costs for the 1981-82 crop year is outlined in Table V-1. The estimated volume of current statutory commodities is 30.0 million tonnes. It is recommended that anomalies relating to the exclusion from statutory rates of canola and linseed meal moving to the west coast, as well as canola and linseed oil, be removed by including these products under the new statutory rate structure. This would add a further 400 000 tonnes to the estimated volume of grain shipments to be used in calculating costs for the 1981-82 crop year, for a grand total of 30.4 million tonnes. No other grains or grain products are recommended for inclusion under the new statutory arrangements.

b) Railway Revenue Shortfall

Basic to the determination of railway revenue shortfall is the determination of railway costs. The differences between the shippers and the railways were outlined in Section IV.(4), and will not be repeated here. Table V-2 embodies the recommendations for the resolution of these differences for 1980 and 1981-82.

On the matter of the appropriate cost of capital rate, the basic issue is whether the transportation of grain is less risky than the transportation of other freight. While we tend to believe the risk associated with grain transportation might be less than that for other freight, we had neither the resources nor the time necessary to resolve this issue. It is recommended that the C.T.C., as part of its current cost of capital inquiry, should provide a ruling on this matter. We suggest that the permanent cost of capital rate for grain transportation should be specified as being equal to the cost of capital rate approved by the C.T.C. for minimum and maximum rate regulation purposes, less whatever percentage point reduction the C.T.C. may find justified by risk considerations. In the meantime, it is recommended that 21.0% be used until the C.T.C. makes its ruling. The arbitrary selection of 21% is not related to subsidy considerations; it is our understanding from the discussions that the shippers agree with this interpretation.

Based on a recent C.T.C. ruling, the assets purchased with the rehabilitation funds are not included in the cost calculations. However, if this ruling is overturned by future actions of the Federal Government, the C.T.C. or the courts, the cost of capital on the assets should then be included in the base year costs and the amount of the gross railway revenue shortfall adjusted accordingly.

Although the shippers and the railways agreed that there should be a contribution to constant costs, there were major differences in the conceptual basis and the amount. These differences were outlined in a previous section. In recommending a resolution of this issue, a few conceptual judgements were made. First, we interpret our mandate, relative to the railway revenue problem, to be to resolve the railways' problem of inadequate compensation for the movement of grain, rather than to solve the railways' requirements for funds to expand capacity. Consequently we accept the railways' conceptual approach to contribution to constant costs. Second, some portion of the contribution to constant costs should be related to the railways' performance. This concept is acceptable to both railways and shippers.

The actual amount to be allocated for contribution to constant costs is a matter of judgement. According to the National Transportation Act, the amount may vary from 0% to 150% of long run variable costs. Realistically, we agree that grain should make some contribution to costs so that statutory grain will not inhibit the railways from maintaining an ongoing financially viable, self-sustaining railway system. The determination of a specific level of contribution depends on the subjective interpretation of equity and sufficiency. As a matter of judgement, we are recommending that the contribution to constant costs be set at 20% of volume related variable costs. Further, we recommend that the railways receive the first 12% as part of the rate structure and that the remaining 8% be related to performance. The relationship to performance is outlined in more detail in Section V (5).

TABLE V-1

ESTIMATED SHIPMENT VOLUMES FOR THE 1981-82 CROP YEAR

1. <u>Current Statutory Commodities</u>	MILLION TONNES
1. Estimated exports of the major statutory grains and products (C.W.B. projection of 26 million less projected exports of canola oil)	25.8
2. Shipments to the eastern domestic market of the major statutory grains and products	3.0
3. Dockage in above shipments	0.8
4. Minor statutory grains and products	<u>0.4</u>
TOTAL	30.0
II. <u>Additional Statutory Shipments If</u>	
<u>Canola and Linseed Products are Given Parity</u>	
1. Total canola product rail shipments to statutory destinations	0.81
2. Less current statutory canola meal shipments	0.42
3. Plus current non-statutory linseed product shipments to statutory destinations	<u>0.01</u>
TOTAL	0.40
III. Grand Total	30.4

TABLE V-2

RAILWAY REVENUE SHORTFALL, 1980 and 1981-82
(million dollars)

	1980	1981-82*
1. Volume of grain shipments (million tonnes)	27.0	30.4
2. Railway Costs		
a) Volume Related		
- Cost of capital	63.1	
- NAR and milling in transit	15.3	
- All others	343.8	
- Total volume related costs	422.2	592.3
b) Line Related		
- Cost of capital	32.1	
- Normalized maintenance	34.6	
- NAR	0.8	
- All others	27.4	
- Total line related costs	94.9	108.8
c) Long run variable costs	517.1	701.1
d) Contribution to constant costs	84.4	118.4
e) Total railway revenue requirements	601.5	819.5
3. Revenue from statutory rates	132.0	148.6
4) Gross Railway revenue shortfall	469.5	670.9

* A cost index of 1.246 was applied to volume related costs and contribution to constant costs, and an index of 1.146 was applied to line related costs. These indices are average for CN and CP, and are obtained from Table IV -3.

On the matter of normalized maintenance, there was an initial difference of opinion between the shippers and the railways as to the treatment of this cost item in the cost base. The two sides eventually agreed that normalized maintenance be included in the cost base, but it would be paid out only as actual expenditures were incurred. This would represent part of the direct payment to railways.

Given these assumptions, we have calculated the total railway revenue requirements for 1980 to be \$601.5 million. After deducting the revenue from statutory rates (\$132 million), the gross railway revenue shortfall is \$469.5 million. This compares to \$552 million suggested by the railways and \$392.3 million suggested by the shippers.

The adjustment to the 1981-82 base requires an adjustment in volume as well as cost increases. The volume adjustment is illustrated in Table V-1; the 1981-82 volume being 30.4 million tonnes. The adjustment for cost increases is much more complex in that productivity gains must be taken into account, along with price increases.

Turning first to price increases, the shippers have assumed a 15% increase over 1980 while the railways have presented cost indices that have been approved by the C.T.C. for 1981 and 1982, and have been adjusted to correspond to the 1981-82 crop year. These are shown in Table IV-3. We are somewhat concerned with variations between CN and CP with respect to the different impacts of cost increases and different weighting factors. We recommend that C.T.C. carefully review the procedures used for projecting cost increases in order to arrive at a common base for weighting and component cost increases. This review should be completed by December 31, 1982 so that the new procedure could be applied for crop year 1983-84.

For purposes of arriving at the 1981-82 cost base, we took an average of the CN and CP cost indices for volume related and line related costs. This average was calculated to be 1.246 for volume related costs and 1.146 for line related costs. The index of 1.246 was applied to the contribution to constant costs since this component is a percentage of volume related costs. The gross railway revenue shortfall for 1981-82 was calculated to be \$670.9 million.

However, it was recognized by both the shippers and the railways that productivity gains resulting from the abandonment of unprotected branch lines and the replacement of box cars with hopper cars would tend to reduce the cost increases mentioned above. Based on information provided by the railways (Table V-3), the abandonment of 175.6 miles of branch lines and the replacement of box cars with hopper cars between 1980 and 1981-82 would result in a cost saving of \$22.9 million. These savings were applied to the appropriate cost categories (as shown in Table V-4), and the productivity adjusted gross railway revenue shortfall for 1981-82 was calculated to be \$644.1 million. This compares to \$601 million calculated by the shippers and \$771 million calculated by the railways (without productivity considerations).

c) Federal Government Capital Program in Grain Transportation

The Federal Government has been involved in various capital programs relating to grain transportation for some time. These programs include the rehabilitation of protected branch lines, the purchase of new hopper cars, and long term leases of hopper cars for grain transportation.

The participants in the consultation process urged the retention of these programs until their completion. In the case of rehabilitation of the protected branch lines, this would be in 1990-91. The projected cost for the period 1982-83 to 1985-86 is \$393 million (Table V-5); it is our understanding that the Federal Government has committed itself for this amount. For the period 1986-87 to 1990-91, the estimated cost is \$757 million. We concur with the recommendation for the completion of the rehabilitation program through to 1990-91. However, we further recommend that all rehabilitation beyond 1985-86 be carefully scrutinized in the context of any changes in country elevator configuration to ensure that only branch lines that are essential for the movement of grain, regardless of their "protected" status, be rehabilitated.

The hopper car purchase program for 1981-82 to 1985-86 is the one recommended by the Grain Transportation Authority, and is estimated to cost \$383 million. The Federal Government recently placed orders for 1,280 hopper cars for 1982-83 at a cost of \$82 million. We recommend the completion of the hopper car purchase program, but with the proviso that each year's purchase be reviewed in light of trends in volume of grain to be shipped and productivity gains from the earlier purchase of hopper cars.

The duration of the existing hopper car lease is to 2005-06, and the annual cost is currently \$12 million. We recommend that the Federal Government continue with this commitment. The shipper group also recommended that the Federal Government provide for the cost of ownership of railway tank cars for the movement of canola and linseed oil, at a cost of \$3 million per year until 1991-92. Given the mounting Federal Government deficit, and the already large commitments to grain transportation, we do not recommend that the Federal Government undertake any additional capital programs in grain transportation at this time. However, the Federal Government could consider purchasing this equipment with the funds allocated to the hopper car purchase.

d) Sharing of Future Cost Increases

Once the base level (1981-82) of railway costs and revenue shortfall is established, the next task is to project future cost increases. Future cost increases are largely influenced by changes in volume, productivity and efficiency gains, inflation, Federal Government capital programs, the agricultural adjustment shortfall, and phasing. The manner of sharing these future cost increases among shippers, railways, and the Federal Government follows.

TABLE V-3

COST IMPLICATIONS OF PRODUCTIVITY
GAINS RESULTING FROM ABANDONMENT
OF UNPROTECTED BRANCH LINES AND
REPLACEMENT OF BOXCARS WITH HOPPER CARS
1981-82 TO 1985-86 (million dollars)

	1981-82	1982-83	1983-84	1984-85	1985-86
CN*					
Reduction due to abandon- ment of unprotected branch lines	1.9	2.7	5.9	9.8	14.3
Savings resulting from replacement of boxcars with hopper cars	<u>8.0</u>	<u>13.5</u>	<u>17.4</u>	<u>24.6</u>	<u>33.0</u>
Total	9.9	16.2	23.3	34.4	47.3
CP**					
Reduction due to abandon- ment of unprotected branch lines	1.2	3.2	5.7	8.7	12.0
Savings resulting from replacement of boxcars with hopper cars	<u>11.8</u>	<u>17.4</u>	<u>24.2</u>	<u>33.1</u>	<u>43.2</u>
Total	<u>13.0</u>	<u>20.6</u>	<u>29.9</u>	<u>41.8</u>	<u>55.2</u>
Grand Total	22.9	36.8	53.2	76.2	102.5

* Based on the abandonment of 110.8 miles of branch lines in 1981-82,
and a further abandonment of 560 miles over the period 1982-83 to 1985-86.

** Based on the abandonment of 64.8 miles of branch lines in
1981-82, and a further abandonment of 386.8 miles over the period
1982-83 to 1985-86.

TABLE V-4

ADJUSTING 1981-82 COST BASE FOR PRODUCTIVITY
INCREASES DUE TO ABANDONMENT OF 175.6 MILES OF
BRANCH LINE BETWEEN 1980 AND 1981-82 AND THE
REPLACEMENT OF BOXCARS WITH HOPPER CARS DURING
THE SAME PERIOD (MILLION DOLLARS)

1. Volume Related Variable Costs	\$592.3
2. Less Productivity Adjustment for Hopper Cars*	<u>19.8</u>
3. Productivity Adjusted Volume Related Costs	572.5
4. Line Related Variable Costs	108.8
5. Less Productivity Adjustment for Abandonment of Branch Lines*	<u>3.1</u>
6. Productivity Adjusted Line Related Costs	105.7
7. Productivity Adjusted Long Run Variable Costs (3 + 6)	678.2
8. Contribution to Constant Costs (20% of line 3)	<u>114.5</u>
9. Adjusted Total Railway Revenue Requirements (7 + 8)	792.7
10. Revenue from Statutory Rates	<u>148.6</u>
11. Adjusted Gross Railway Revenue Shortfall (9 - 10)	644.1

* Based on information from Table V-3

TABLE V-5

FEDERAL GOVERNMENT CAPITAL PROGRAM RELATING TO GRAIN TRANSPORTATION
1982-83 TO 1991-92 (million dollars)

	1982-83	1983-84	1984-85	1985-86	1986-87	1987-88	1988-89	1989-90	1990-91	1991-92
Branch Line Rehabilitation	85	93	102	113	124	136	150	165	182	-
New Hopper Car Purchases	82	91	100	110	-	-	-	-	-	-
Existing Hopper Car Leases *	12	12	12	12	12	12	12	12	12	12
TOTAL	179	196	214	235	136	148	162	177	194	12

* Although currently estimated at \$12 million per annum, this cost may increase to \$17 million in the future.

1) Volume Changes

It is recommended that the cost of transporting future volume increases (beyond 30.4 million tonnes) be borne by the producers as they tend to be the major beneficiaries of volume increases. Further, the projection of a fixed percentage increase in volume, given the substantial year to year variability in grain production and marketing, is not totally realistic. Although cost calculations beyond 1981-82 do not reflect volume adjustments (Tables V-6), the impact of volume increases for selected years is discussed later in the report. In years when fewer than 30.4 million tonnes are shipped, the unspent "Crow benefit" that would go to the railways should be diverted into the Grain Freight Rate Stabilization Fund (Section IV-6).

ii) Productivity and Efficiency Gains

Productivity and efficiency gains are also very difficult to predict. For purposes of this report, two specific measures are considered: the abandonment of unprotected branch lines and the replacement of boxcars with hopper cars. A reduction in the unprotected branch line network would not only reduce line-related costs, but maintenance and rehabilitation costs as well. This would also reduce car requirements in that cars used on branch line take longer to complete a round trip. Thus, fewer cars would be required to carry the same volume of grain from a reduced branch line network.

The railways have estimated the savings from abandoning 946.8 miles of unprotected branch lines over the period 1982-83 to 1985-86 to be \$62.3 million (Table V-3). We believe that this saving should be shared on a 50-50 basis between the railways and the shippers. Thus, this saving and the sharing is reflected in Tables V-6 for the period 1982-83 to 1985-86. In order to obtain this saving, it is necessary that the C.T.C. resume and complete its abandonment hearings for unprotected branch lines as soon as possible. No projections are made for savings from abandonment of branch lines beyond 1985-86. However, any variations in branch line abandonment should be taken account of in the periodic review of railway costs in the future.

The second source of productivity gains incorporated into the calculations in this report is the replacement of the grain boxcar fleet with hopper cars. This would reduce the cost of fuel, car repairs and switching, and would eliminate car cleaning and grain door costs. The railways have estimated that the replacement of boxcars with hopper cars, under the Federal Government capital program outlined earlier, would result in a cost saving of \$206.4 million over the period 1982-83 to 1985-86 (Table V-3). As in the case of savings from branch line abandonment, we believe this saving should be shared on a 50-50 basis between the railways and the shippers. These savings, and the sharing, are reflected in Tables V-6. However, any deviations from the purchase of hopper cars as outlined in Table V-5 would require an adjustment in the cost base at the time of the next costing review.

However, it should be noted that shipments through the Port of Churchill depend upon a continued supply of boxcars as the rail line serving Churchill is incapable of carrying the hopper cars currently in use. If Churchill is expected to continue to handle a portion of western grain exports, some provision must be made for a continuing boxcar supply. It is recommended that the car supply problem for the Port of Churchill be reviewed in co-operation with CN Rail and the shippers.

Only two sources of productivity gains have been mentioned. Many others exist, and we recommend strongly the pursuit of such gains in the mutual interest of the shippers, railways and the Federal Government.

iii) Cost Increases

Inflationary cost increases between calendar year 1980 and crop year 1981-82 were based on railway cost indices approved by the C.T.C. We recommend that future rate increases for grain be based on C.T.C. approved projected cost indices, but with the following conditions:

1. The C.T.C. approved component cost indices (e.g., fuel, labour, etc.) should be the same for both railways, in as much as there shall be a distance-related rate structure.
2. The weightings of the cost components should be reviewed at the time of each major costing review; the next review should take place in 1985-86, and subsequent reviews should take place every four years.
3. C.T.C. should approve the projected cost indices soon enough to announce a new rate structure in advance of the coming crop year, e.g., the projected cost indices for crop year 1983-84 should be approved by C.T.C. by January 31, 1983, so that the freight rate structure can be announced on April 1, 1983, to take effect August 1, 1983.
4. Any over or under estimation of projected cost increases should be accounted for in setting cost indices for subsequent years.

In the meantime, it was necessary to make some assumptions about the level of future cost increases starting with 1982-83 and carrying forward to 1991-92. Closely related to this is the need to make some assumptions relating to the sharing of future cost increases between the producers and the Federal Government. Some of the representatives in the discussions adopted a firm position that they were prepared to share future cost increases on a 50-50 basis with the Federal Government up to a maximum of 3%. Thus, if cost increases were 4%, shippers would pay 2%; if they were 6%, shippers would pay 3%; and if they were 8%, shippers would still pay 3%. The Federal Government, in the Policy Statement of February 8 and subsequent discussions, took the view that shippers should bear a significant portion of future cost increases.

It is recognized that the projected rates of cost increases used in Tables V-6A to V-6F are less than those currently being experienced in railway operations. We have noted international inflationary trends and expect that additional productivity gains throughout the entire system, coupled with a lessening of those inflationary pressures will result in overall lower rates of cost increases. (Few economic forecasters are prepared to offer firm opinions on inflation rates even two and three years into the future. Accordingly, the projections in these tables are just that - attempts to indicate what inflation may be in the remainder of the 1980s.)

Different assumptions about the level of future cost increases and the sharing of these increases are explored in Tables V-6A to V-6F. They are outlined below:

1. Table V-6A - Cost increases of 8% for 1982-83 to 1985-86, and 6% thereafter; shippers share up to 3% of cost increases starting in 1983-84.
2. Table V-6B - Cost increases of 8% for 1982-83 to 1985-86, and 6% thereafter; shippers share up to 3% for cost increases during 1983-84 to 1985-86, and starting in 1986-87, pay the first 3% of cost increases, and share up to 3% of further cost increases to a total of 4½%.
3. Table V-6C - Cost increases of 8% for 1982-83 to 1985-86, and 7% thereafter; shippers share up to 3% of cost increases during 1983-84 to 1985-86, and starting in 1986-87, pay the first 3% of cost increases, and share up to 4% of further cost increases to a total of 5%.
4. Table V-6D - Cost increases of 8% for 1982-83 to 1985-86 and 6% thereafter; shippers share up to 3% of cost increases during 1983-84 to 1985-86, and starting in 1986-87, pay the first 3% and increase by ½% each year until 1992-93 when shippers would be paying all cost increases (6%).
5. Table V-6E - Cost increases of 10% for 1982-83 and thereafter; shippers share up to 3% of cost increases starting in 1983-84.
6. Table V-6F - Cost increases of 10% for 1982-83 and thereafter; shippers share up to 3% of cost increases during 1983-84 to 1985-86, and starting in 1986-87, pay the first 3% and increase by 1% each year until 1993-94 when shippers would be paying all cost increases (10%).

iv) Agricultural Adjustment Shortfall

The shippers have recommended that the Federal Government undertake to pay the agricultural adjustment shortfall as outlined earlier over the period 1983-84 to 1988-89. It was originally recommended that the agricultural adjustment shortfall be instituted at the beginning of the 1982-83 crop year, but because of timing problems with implementation, it was agreed to defer this to the 1983-84 crop year. We concur in this recommendation. The calculation of this shortfall is shown in Table V-7 and is incorporated into Tables V-6.

v) Phasing

A number of aspects of future cost increases are phased. These include:

1. Producers do not start paying cost increases until 1983-84.
2. The contribution to constant costs is gradually phased in so as to moderate the financial impact on the Federal Government and the shippers - specifically, there is no contribution in 1982-83, 25% in 1983-84, 50% in 1984-85, 75% in 1985-86, and 100% in 1986-87. Thus the railways should become "whole" starting on August 1, 1986.
3. The agricultural adjustment shortfall is gradually phased out, starting at \$77.5 million in 1983-84 and dropping to \$17.3 million in 1988-89. The total expenditure for the program is \$305.1 million.
4. The payment of the gross railway revenue shortfall is gradually phased from 100% going to the railways in 1982-83 to 19% going to the railways by 1989-90 and 81% going to producers.
5. The Federal Government's capital program in grain transportation is gradually phased out until only a \$12 million annual commitment remains in 1991-92.

vi) The Cost

The total cost to the Federal Government of this package for the period 1982-83 to 1985-86 (assuming 8% cost increases and the phasing and sharing described above) would be \$3.5 billion (Tables V-6A to V-6D). This is made up of \$2.47 billion for gross railway revenue shortfall and sharing of cost increases, \$824 million for Federal Government capital programs in grain transportation, and \$206 million for the agricultural adjustment shortfall. In 1985-86, producers would be paying 24.6% of the total railway revenue requirements (compared to 18.7% in 1981-82). Their cost per tonne would have increased from \$4.89 to \$7.10, an increase of 45% over 1981-82. If cost increases were 10% per annum for the period 1982-83 to 1985-86, the total cost to the Federal Government would be \$3.66 billion (Tables V-6E and V-6F).

Considering the period beyond 1985-86 and choosing 1991-92 as a focal point, producers would be paying anywhere from 25.1% to 39.5% of the total railway revenue requirements, depending upon the assumptions regarding cost increases and sharing. Under the shippers' proposal for cost sharing (up to 3%) and 6% cost increases beyond 1985-86 (Table V-6A), shippers would be paying 31.4% of the total cost, or \$13.33/tonne (an increase of 173% over 1981-82). If we assume a greater sharing of cost increases by producers (e.g., Tables V-6B and V-6C), shippers would be paying approximately 39% of the total railway revenue requirements by 1991-92, or between \$16.45 and \$17.75/tonne, an increase of 236 to 263% over 1981-82.

V

- 19 -

TABLE V-6A

COST IMPLICATIONS OF OPTION ASSUMING COST INCREASES OF 8% FOR 1982-83 TO 1985-86 AND 6% THEREAFTER, SHIPPERS SHARING UP TO 3% OF COST INCREASES STARTING IN 1983-84
(million dollars)

	Base 1981-82	1982-83	1983-84	1984-85	1985-86	1986-87	1987-88	1988-89	1989-90	1990-91	1991-92
A. Gross Railway Revenue Shortfall											
1. Volume-Related Variable Costs	592.3	618.3	651.1	680.8	704.1	706.0	748.3	793.2	840.8	891.3	944.7
2. Less Productivity Adjustment for Hopper Cars	19.8	15.4	20.8	28.8	38.1	-	-	-	-	-	-
3. Productivity Adjusted Volume- Related Costs	572.5	602.9	630.3	652.0	666.0	706.0	748.3	793.2	840.8	891.3	944.7
4. Line-Related Variable Costs	108.8	114.2	120.3	123.7	123.7	117.2	124.2	131.7	139.6	148.0	156.9
5. Less Productivity Adjustment for Branch Line Abandonment	3.1	2.8	5.8	9.2	13.1	-	-	-	-	-	-
6. Productivity Adjusted Line- Related Costs	105.7	111.4	114.5	114.5	110.6	117.2	124.2	131.7	139.6	148.0	156.9
7. Productivity Adjusted Long Run Variable Costs (3 + 6)	678.2	714.3	744.8	766.5	776.6	823.2	872.5	924.9	980.4	1,039.3	1,101.6
8. Contribution to Constant Costs (20% of line 3)	114.5	-	31.5	65.2	99.9	161.2	149.7	158.6	168.2	178.3	188.9
9. Total Railway Revenue Requirements (7+8)	792.7	714.3	776.3	831.7	876.5	964.4	1,022.2	1,083.5	1,148.6	1,217.6	1,290.5
10. Revenue from Statutory Rates	148.6	148.6	148.6	148.6	148.6	148.6	148.6	148.6	148.6	148.6	148.6
11. Gross Railway Revenue Shortfall (9-10)	644.1	565.7	627.7	683.1	727.9	815.8	873.6	934.9	1,000.0	1,069.0	1,141.9
12. Shippers' share of cost increases	-	-	21.4	44.7	67.1	93.4	122.3	153.0	185.5	220.0	256.5
13. Federal government's share of rail- way revenue shortfall	-	565.7	606.3	638.4	660.8	722.4	751.3	781.9	814.5	849.0	885.4
B. Federal Government Capital Program (Table V-5)	-	179.0	196.0	214.0	235.0	136.0	148.0	162.0	177.0	194.0	12.0
C. Agricultural Adjustment Shortfall (Table V-7)	-	-	77.5	69.6	59.0	47.9	33.8	17.3	-	-	-
D. Total Cost to Federal Government (line 13 + B + C)	-	744.7	879.8	922.0	954.3	906.3	933.1	961.2	991.5	1,043.0	897.4
E. Shippers' Share of Total Railway Revenue Requirements (2) (line 10 + 12 ÷ line 9)	18.7	20.8	21.9	23.2	24.6	25.1	26.5	27.8	29.1	30.3	31.4

TABLE V-6B

COST IMPLICATIONS OF OPTION ASSUMING COST INCREASES OF 8% FOR 1982-83 TO
1985-86 AND 6% THEREAFTER, SHIPPERS SHARING UP TO 3% OF COST INCREASES FOR THE PERIOD 1983-84 TO 1985-86, AND
PAYING THE FIRST 3% OF COST INCREASES AFTER 1985-86 AND SHARING THE NEXT 3% FOR A TOTAL OF 4%,
(million dollars)

	Base 1981-82	1982-83	1983-84	1984-85	1985-86	1986-87	1987-88	1988-89	1989-90	1990-91	1991-92
A. Gross Railway Revenue Shortfall											
1. Volume-Related Variable Costs	592.3	618.3	651.1	680.8	704.1	706.0	748.3	793.2	840.8	891.3	944.7
2. Less Productivity Adjustment for Hopper Cars	19.8	14.5	20.8	28.8	38.1	-	-	-	-	-	-
3. Productivity Adjusted Volume- Related Costs	572.5	602.9	630.3	652.0	666.0	706.0	748.3	793.2	840.8	891.3	944.7
4. Line-Related Variable Costs	108.8	114.2	120.3	123.7	123.7	117.2	124.2	131.7	139.6	148.0	156.9
5. Less Productivity Adjustment for Branch Line Abandonment	3.1	2.8	5.8	9.2	13.1	-	-	-	-	-	-
6. Productivity Adjusted Line- Related Costs	105.7	111.4	114.5	114.5	110.6	117.2	124.2	131.7	139.6	148.0	156.9
7. Productivity Adjusted Long Run Variable Cost (3 + 6)	678.2	714.3	744.8	766.5	766.6	823.2	872.5	924.9	980.4	1,039.3	1,101.6
8. Contribution to Constant Costs (20% of line 3)	114.5	-	31.5	65.2	99.9	141.2	149.7	158.6	168.2	178.3	188.9
9. Total Railway Revenue Requirements (7+8)	792.7	714.3	776.3	831.7	876.5	964.4	1,022.2	1,083.5	1,148.6	1,217.6	1,290.5
10. Revenue from Statutory Rates	148.6	148.6	148.6	148.6	148.6	148.6	148.6	148.6	148.6	148.6	148.6
11. Gross Railway Revenue Shortfall (9-10)	644.1	565.7	627.7	683.1	727.9	815.8	873.6	934.9	1,000.0	1,069.0	1,141.9
12. Shippers' share of cost increases	-	-	21.4	44.7	67.1	106.7	150.1	196.1	244.9	296.7	351.4
13. Federal government's share of rail- way revenue shortfall	-	565.7	606.3	638.4	660.8	709.1	723.5	738.8	755.1	772.3	790.5
B. Federal Government Capital Program (Table V-5)		179.0	196.0	214.0	235.0	136.0	148.0	162.0	177.0	194.0	12.0
C. Agricultural Adjustment Shortfall (Table V-7)		-	77.5	69.6	59.0	47.9	33.8	17.3	-	-	-
D. Total Cost to Federal Government (line 13 + B + C)		744.7	879.8	922.0	954.3	892.5	905.3	918.1	932.1	966.3	802.5
E. Shippers' Share of Total Railway Revenue Requirements (1) (line 10 + 12 + line 9)	18.7	20.8	21.9	23.2	24.6	26.5	29.2	31.8	34.3	36.6	38.7

TABLE V-6C

COST IMPLICATIONS OF OPTION ASSUMING COST INCREASES OF 8% FOR 1982-83 TO
AND 7% THEREAFTER, SHIPPERS SHARING UP TO 3% OF COST INCREASES FOR THE PERIOD 1983-84 TO 1985-86,
PAYING THE FIRST 3% OF COST INCREASES AFTER 1985-86 AND SHARING THE NEXT 4% FOR A TOTAL OF 5%,
(million dollars)

	Base 1981-82	1982-83	1983-84	1984-85	1985-86	1986-87	1987-88	1988-89	1989-90	1990-91	1991-92
A. Gross Railway Revenue Shortfall											
1. Volume-Related Variable Costs	592.3	618.3	651.1	680.8	704.1	712.6	762.5	815.9	873.0	934.1	999.5
2. Less Productivity Adjustment for Hopper Cars	19.8	15.4	20.8	28.8	38.1	-	-	-	-	-	-
3. Productivity Adjusted Volume-											
Related Costs	572.5	602.9	630.3	652.0	666.0	712.6	762.5	815.9	873.0	934.1	999.5
4. Line-Related Variable Costs	108.8	114.2	120.3	123.7	123.7	118.3	126.6	135.5	145.0	155.2	166.1
5. Less Productivity Adjustment for Branch Line Abandonment	3.1	2.8	5.8	9.2	13.1	-	-	-	-	-	-
6. Productivity Adjusted Line-											
Related Costs	105.7	111.4	114.5	114.5	110.6	118.3	126.6	135.5	145.0	155.2	166.1
7. Productivity Adjusted Long Run Variable Cost (3 + 6)	678.2	714.3	744.8	766.5	776.6	830.9	889.1	951.4	1,018.0	1,089.3	1,165.6
8. Contribution to Constant Costs (20% of line 3)	114.5	-	31.5	65.2	99.9	142.5	152.5	163.2	174.6	186.8	199.9
9. Total Railway Revenue Requirements (7+8)	792.7	714.3	776.3	831.7	876.5	1,041.6	1,041.6	1,114.6	1,192.6	1,276.1	1,365.5
10. Revenue from Statutory Rates	148.6	148.6	148.6	148.6	148.6	148.6	148.6	148.6	148.6	148.6	148.6
11. Gross Railway Revenue Shortfall (9-10)	644.1	565.7	627.7	683.1	727.9	824.8	893.0	966.0	1,044.0	1,127.5	1,216.9
12. Shippers' share of cost increases	-	-	21.4	44.7	67.1	110.9	159.6	211.7	267.4	327.0	390.9
13. Federal Government's share of rail- way revenue shortfall	565.7	565.7	606.3	638.4	660.8	713.9	733.4	754.4	776.6	800.5	826.0
B. Federal Government Capital Program (Table V-5)		179.0	196.0	214.0	235.0	136.0	148.0	162.0	177.0	194.0	12.0
C. Agricultural Adjustment Shortfall (Table V-7)		-	77.5	69.6	59.0	47.9	33.8	17.3	-	-	-
D. Total Cost to Federal Government (line 13 + B + C)		744.7	879.8	922.0	954.3	897.8	915.2	933.6	953.6	994.5	838.0
E. Shippers' Share of Total Railway Revenue Requirements (2) (line 10 + 12 ÷ line 9)	18.7	20.8	21.9	23.2	24.6	26.7	29.6	32.3	34.9	37.3	39.5

COST IMPLICATIONS OF *OPTION ASSUMING COST INCREASES OF 8% FOR 1982-83 TO 1985-86 AND 6% THEREAFTER, SHIPPERS SHARING UP TO 3% OF COST INCREASE DURING 1983-84 TO 1985-86:
STARTING IN 1986-87 SHIPPERS PAY FIRST 3% AND INCREASE BY 1/2% EACH YEAR UNTIL 1992-93 SHIPPERS ARE PAYING ALL COST INCREASES (6%) (million dollars)

[illegible]

TABLE V-6E
COST IMPLICATIONS OF OPTION ASSUMING COST INCREASES OF 10% FOR 1982-83 AND THEREAFTER,
SHIPPERS SHARING UP TO 3% OF COST INCREASES STARTING IN 1983-84
(million dollars)

	Base 1981-82	1982-83	1983-84	1984-85	1985-86	1986-87	1987-88	1988-89	1989-90 *	1990-91	1991-92
A. Gross Railway Revenue Shortfall											
1. Volume-Related Variable Costs	592.3	629.8	675.8	720.5	760.9	795.1	874.6	962.1	1,058.3	1,164.1	1,280.5
2. Less Productivity Adjustment for Hopper Cars	19.8	15.4	20.8	28.8	38.1	-	-	-	-	-	-
3. Productivity Adjusted Volume-											
4. Related Costs	572.5	614.4	655.0	691.7	722.8	795.1	874.6	962.1	1,058.3	1,165.1	1,280.5
5. Less Productivity Adjustment for Branch Line Abandonment	108.8	116.3	124.8	130.9	133.9	132.9	146.2	160.8	176.9	194.6	214.1
6. Productivity Adjusted Line-	3.1	2.8	5.8	9.2	13.1	-	-	-	-	-	-
7. Related Costs	105.7	113.5	119.0	121.7	120.8	132.9	146.2	160.8	176.9	194.6	214.1
8. Contribution to Constant Costs	678.2	727.9	774.0	813.4	843.6	928.0	1,020.8	1,122.9	1,235.2	1,358.7	1,494.6
9. Total Railway Revenue Requirements (7+8)	114.5	-	32.8	69.2	108.4	159.0	174.9	192.4	211.7	232.8	255.1
10. Revenue from Statutory Rates	792.7	727.9	806.3	882.6	952.0	1,087.0	1,195.7	1,315.3	1,446.9	1,591.5	1,749.7
11. Gross Railway Revenue Shortfall (9-10)	148.6	148.6	148.6	148.6	148.6	148.6	148.6	148.6	148.6	148.6	148.6
12. Shippers' share of cost increase	644.1	579.3	658.2	734.0	803.4	938.4	1,047.1	1,166.7	1,298.3	1,442.9	1,601.1
13. Federal Government's share of rail- way revenue shortfall		579.3	27.5	50.2	71.0	99.5	132.1	168.0	207.5	250.9	296.9
B. Federal Government Capital Program (Table V-5)		179.0	196.0	214.0	235.0	136.0	148.0	162.0	177.0	194.0	12.0
C. Agricultural Adjustment Shortfall (Table V-7)		-	77.5	69.6	59.0	47.9	33.8	17.3	-	-	-
D. Total Cost to Federal Government (line 13 + B + C)		758.3	904.2	967.4	1,026.4	1,022.8	1,096.8	1,178.0	1,267.8	1,386.0	1,316.2
E. Shippers' Share of Total Railway Revenue Requirements (2) (line 10 + 12 ÷ line 9)	18.7	20.4	21.8	22.5	23.1	22.8	23.5	24.1	24.6	25.1	25.5

V

- 24 -

TABLE V-6F

COST IMPLICATIONS OF OPTION ASSUMING COST INCREASES OF 10% FOR 1982-83 AND THEREAFTER,
 SHIPPERS SHARING UP TO 3% OF COST INCREASE DURING 1983-84 TO 1985-86; STARTING IN 1986-87
 SHIPPERS PAY FIRST 3% AND INCREASE BY 1% EACH YEAR UNTIL 1993-94 WHEN SHIPPERS ARE PAYING ALL COST INCREASES (10%),
 (million dollars)

	Base 1981-82	1982-83	1983-84	1984-85	1985-86	1986-87	1987-88	1988-89	1989-90	1990-91	1991-92	1992-93	1993-94
A. Gross Railway Revenue Shortfall													
1. Volume-Related Variable Costs	592.3	629.8	675.8	720.5	760.9	795.1	874.6	962.1	1,058.3	1,164.1	1,280.5	1,408.6	1,549.5
2. Less Productivity Adjustment for Hopper Cars	19.8	15.4	20.8	28.8	38.1	-	-	-	-	-	-	-	-
3. Productivity Adjusted Volume- Related Costs	572.5	614.4	655.0	691.7	722.8	795.1	874.6	962.1	1,058.3	1,164.1	1,280.5	1,408.6	1,549.5
4. Line-Related Variable Costs	108.8	116.3	124.8	130.9	133.9	132.9	146.2	160.8	176.9	194.6	214.1	235.5	259.1
5. Less Productivity Adjustment for Branch Line Abandonment	3.1	2.8	5.8	9.2	13.1	-	-	-	-	-	-	-	-
6. Productivity Adjusted Line- Related Costs	105.7	113.5	119.0	121.7	120.8	132.9	146.2	160.8	176.9	194.6	214.1	235.5	259.1
7. Productivity Adjusted Long Run Variable Cost (3+6)	678.2	727.9	774.0	813.4	843.6	928.0	1,020.8	1,122.9	1,235.2	1,358.7	1,494.6	1,644.1	1,808.6
8. Contribution to Constant Costs (20% of line 3)	114.5	-	32.8	69.2	108.4	159.0	174.9	192.4	211.7	232.8	255.1	281.7	309.9
9. Total Railway Revenue Requirements (7+8)	92.7	727.9	806.8	882.6	952.0	1,087.0	1,195.7	1,315.3	1,446.9	1,591.5	1,749.7	1,925.8	2,118.5
10. Revenue from Statutory Rates	148.6	148.6	148.6	148.6	148.6	148.6	148.6	148.6	148.6	148.6	148.6	148.6	148.6
11. Gross Railway Revenue Shortfall (9-10)	644.1	579.3	658.2	734.0	803.4	938.4	1,047.1	1,166.7	1,298.3	1,442.9	1,601.1	1,777.2	1,969.9
12. Shippers' share of cost increases	-	-	27.5	50.2	71.0	99.5	143.0	202.8	281.8	383.0	505.6	668.6	861.3
13. Federal Government's share of rail- way revenue shortfall	579.3	579.3	630.7	683.8	732.4	838.9	904.1	963.9	1,016.5	1,059.9	1,095.5	1,108.6	1,108.6
B. Federal Government Capital Program (Table V-5)	179.0	196.0	214.0	235.0	235.0	136.0	148.0	162.0	177.0	194.0	12.0	12.0	12.0
C. Agricultural Adjustment Shortfall (Table V-7)	-	-	77.5	69.6	59.0	47.9	33.8	17.3	-	-	-	-	-
D. Total Cost to Federal Government (line 13 + B + C)	758.3	904.2	967.4	1,026.4	1,022.8	1,085.9	1,143.2	1,193.5	1,253.9	1,107.5	1,120.6	1,120.6	1,120.6
E. Shippers' Share of Total Railway Revenue Requirements (2) Line 10 + 12 + line 9)	18.7	20.4	21.8	22.5	23.1	22.8	24.4	26.7	29.7	33.4	37.5	42.4	47.7

TABLE V-7

CALCULATION OF AGRICULTURAL ADJUSTMENT
SHORTFALL AS PROPOSED BY THE SHIPPERS
(million dollars)

	<u>1983-84</u>	<u>1984-85</u>	<u>1985-86</u>	<u>1986-87</u>	<u>1987-88</u>	<u>1988-89</u>	<u>1989-90</u>
A. Volume Related Costs Plus Contribution to Constant (not tied to performance Table V-6A)	\$649.2	691.1	725.9	790.7	838.1	888.4	941.7
B. Gross Railway Revenue Shortfall (line 11 Table V-6A)	627.7	683.1	727.9	815.8	873.6	934.9	1,000.0
C. % of Gross Railway Revenue Shortfall Paid to Railways*	67.2	59.3	51.5	43.6	35.8	27.9	19.1
D. Gross Railway Revenue Shortfall paid to Railways (B X C)	421.8	405.1	374.9	355.7	312.7	260.8	191.0
E. Total Revenue Require- ments (line 9 Table V-6A)	776.3	831.7	876.5	964.4	1,022.2	1,083.5	1,148.6
F. Payment by Shippers to Railway (E - D)	354.5	426.6	501.6	608.7	709.5	822.7	957.6
G. A - F	294.7	264.5	224.3	182.0	128.6	65.7	-
H. Agricultural Adjust- ment Shortfall***							
G x (8.0)** (30.4)	77.5	69.6	59.0	47.9	33.8	17.3	-

* Proposed by Shippers. The % for 1989-90 was adjusted from 15.3 to 19.1 to represent the minimum payment to the railways; that is, line related costs plus the contribution to constant costs tied to performance.

** $G \times \frac{\text{Volume of feed grains and special crops (excluded from statutory rates)}}{\text{Volume of grain covered by statutory rates}}$

*** This will vary slightly with different assumptions on cost increases and cost sharing. This table is based on the same assumptions as Table V-6A.

V. (4) A New Freight Rate Structure for Grain

Principle #1 in the Policy Statement of February 8 specified that "...a statutory framework should be created by Parliament to give effect to the new arrangements...". One aspect of this statutory framework would be a new freight rate structure for grain. The existing structure is derived from Section 271 of the Railway Act.

It is generally assumed that the existing structure is distance related, i.e. 0.5¢/tonne-mile. However, a variety of anomalies exist, and concerns were raised that these might be perpetuated in a new rate structure. It was recommended by the participants in the consultation process, and we concur, that a task force consisting of representatives of all the major participants be established immediately to review the existing rate structure and its anomalies and recommend adjustments before a new rate structure is established in statute.

Once these adjustments have been made, a new base rate structure can be constructed by applying the appropriate multiple to the existing rates. For 1981-82, this multiple would be 5.334 (obtained from the ratio of total railway revenue requirements to revenue from statutory rates). Thus, the new base rate structure for a delivery point with a current rate of \$4.89/tonne would become \$26.08/tonne. A similar calculation would be made for each delivery point.

An upward adjustment to the base rate would be made for each year starting in 1982-83 using CTC approved cost indices. The procedure for this was outlined in the previous section. Since the gross railway revenue shortfall would be paid totally to the railways in 1982-83, the producer would continue to pay the existing statutory rate, e.g. \$4.89/tonne. The railways would then send a freight bill to Transport Canada for the difference between the base rate adjusted for cost increases and the statutory rate. This could be done on a monthly basis. The amount of railway revenue shortfall consisting of line related costs and the contribution to constant costs relating to performance guarantees (8% out of 20%) would be held back pending satisfactory completion of service and actual maintenance on branch lines. The mechanism for triggering the payment of this holdback should be worked out by the proposed Senior Grain Transportation Committee of the Central Co-ordinating Agency.

Starting with 1983-84, the rate structure would get more complex since the railway revenue shortfall would be paid partly to producers and partly to the railways. In addition, the producer would also be bearing a portion of the cost increases.

It is recommended that CTC be given the responsibility for establishing the new rate structure on an annual basis. As indicated earlier, the new rates should be published by April 1 each year and they would take effect on August 1.

The establishment of the new rate structure on an annual basis would not be enshrined in statute. Rather, the base rate for 1981-82 would be established in statute as well as a mechanism for changing the rate on an annual basis. It is recommended that this mechanism be reviewed in 1985-86 and every four years thereafter.

V. (5) Performance and Service Guarantees

a) Introduction

A basic concern of the Federal Government when the consultation process began was to ensure that performance and service guarantees be provided by the railways in return for being compensated.

During the consultation meetings, the farm organizations have emphasized the need for some provision in the statutory framework to ensure that the railways will undertake certain performance and service guarantees and that a system will be developed to monitor actual performance in relation to those guarantees. The two railways agreed that such performance and service guarantees would be provided in return for compensation for the services undertaken.

b) Need for a Co-ordinating Structure

There was agreement that the railways should subscribe to certain performance and service guarantees. There was also a consensus that efficiency and economy measures should be promoted throughout the grain handling and transportation system and that the institution of performance guarantees would help achieve those economies. (See Section IV-5). The major question was how these measures were to be assured in the future.

It became apparent in the discussions that it would not be feasible or practical to list in any exhaustive way in a statutory framework the specific performance and service guarantees to be undertaken by the railways, or the potential efficiency and economy measures that might be undertaken in future years. As outlined in Section IV-3, it was agreed that rather than listing the specific terms in statute, a Central Co-ordinating Agency (C.C.A.) (not unlike the present G.T.A.) should be established and it should be given the responsibility to administer, with a set of principles and guidelines, the performance and service guarantees to be undertaken by the railways, and the efficiency and economy measures that should be undertaken in future years in the grain handling and transportation system.

During the consultation process and subsequent submissions of the various parties it was stressed that the central co-ordinating agency should be free of political influence. The C.C.A. should be a neutral independent agency, free of any vested interest in the grain trade.

c) Structure and Function of a Central Co-ordinating Agency

The Central Co-ordinating Agency would be comprised of three parts:

- a) The Central Co-ordinating Agency itself. This would be an administrative body staffed by an appropriate professional secretariat.
- b) Senior Grain Transportation Committee.
- c) Operating Committee.

i) Senior Grain Transportation Committee (SGTC)

This group would be comprised of senior management of the railways, grain companies, Canadian Wheat Board, Canadian Grain Commission, other transportation companies and a representative(s) of a producer group. (The producer member could be a representative of the CWB Advisory Committee.) This committee, its membership and duties would be defined in legislation and would be chaired by a member elected within the membership of the SGTC. The Secretary to the Senior Committee would be the Co-ordinator of the Central Co-ordinating Agency.

This committee would be responsible for:

- 1. Initiating and approving policy and providing general direction related to the operations of the Central Co-ordinating Agency (CCA).
- 2. Approving performance and service guarantees negotiated, on its behalf, by the CCA.
- 3. Reviewing monthly targets, progress to date and, where necessary, suggesting changes or modifications to operational procedures. (These general suggestions could be passed to an Operations Committee for review/refinement and implementation.) This refers to principle 4a in the Policy Statement. In addition, the committee would monitor the commitments made regarding additional investment programs. This is consistent with principle 4b in the Policy Statement.
- 4. Outlining potential efficiency measures. The SGTC would identify measures to be reviewed by the Operating Committee. It is within this forum that the greatest possible opportunity exists for identifying and resolving mutual problems and recommending new courses of action to help promote efficiency within the system.

5. Establishing in principle where necessary and appropriate, railway operating penalties and bonuses for failure to meet agreed tonnage targets. Further, the shipping penalty mechanism currently in existence would be subject to the approval of the SGTC. The point here is that there must be co-ordination of all factors affecting the allocation system which in turn affects the performance guarantees negotiated.

ii) Duties, Powers and Responsibilities of the Central Co-ordinating Agency

The CCA, in conjunction with the Senior Grain Transportation Committee and the Operating Committee, would be the main co-ordinating body of the grain handling and transportation system. This agency should:

1. be established in statute, with its principles enshrined;
2. be directly responsible to the Minister of Transport;
3. be accountable to the industry; and
4. have its specific powers, duties and responsibilities outlined.

It is recognized that these items may be somewhat contradictory. The consensus reached through the consultative process was for an independent body, free of political influence, that is accountable to the industry. However, unless the industry is willing to finance this body itself, the agency will have to ultimately answer to the Minister of Transport - responsible for the government department that would provide funds for such an agency.

To bring about the performance guarantees and service and performance measures desired by the grain trade the CCA would:

1. a) Negotiate an acceptable annual and monthly target for the movement of grain between railways and grain companies.
- b) Administer the performance guarantees negotiated with the railways and the grain companies. For example,
 - contracts could be negotiated each year, at the beginning of the crop year;
 - a minimum/maximum range of tonnes to be moved during the coming crop year would be established;
 - targets would be broken down by month, grain type, and by port;
 - the railways would commit themselves to move at least the minimum tonnage agreed to for shipment.

2. Outline, review and implement efficiency measures. Outline, review and recommend railway operating penalties and bonuses which in turn would be approved by the SGTC. Review and approve all shipping penalties.
3.
 - a) Prepare weekly allocation plans and targets for the movement of Board and non-Board grains. The CWB block shipping staff would retain responsibility for pulling together a final shipping program. However, deviations above or below a specified range from the CCA allocations would have to be referred back to the CCA for approval.
 - b) Determine and negotiate with the railways the total number of rail cars required to meet Board and private sales needs.
 - c) Clearly define all allocation rules.
 - d) Allocate available railway cars between Board and non-Board sectors, and between various parties in the non-Board sector.
 - e) Allocate available railway cars among various services (i.e. alternate uses).
 - f) Administer and allocate producer cars.
4. To continually monitor the performance of the allocation and grain forwarding system and to prepare recommendations for change in procedures and responsibilities to assure a responsive and effective system.
5. Absorb and integrate the activities of the bulk commodity co-ordinators at Vancouver and Thunder Bay.
6. Prepare and publish all documentation necessary for forward planning.

That is:

1. Ten year transportation plan,
2. Yearly transportation document,
3. Monthly transportation document.

There is also a need to standardize data formats in a more efficient way and to consolidate the flow in a way that serves the user more effectively. The CCA could be an effective control channel.

7. Prepare a detailed audit trail of each and every allocation that would be open to public scrutiny. Subject to confidentiality of information.
8. Have unencumbered access to all relevant sales information - Board/non Board by grain, by port, by month.

The interrelationship of the car allocation function, information access, and performance and service guarantees is such that the individual items cannot be treated or viewed separately.

Transportation demand is based on sales. Any railway performance guarantees agreed to will be based on the projected sales of CWB and the private grain trade for a given year. These annual targets will be translated into monthly and weekly allocations. Detailed (by grain/by port) sales information is essential on a week-to-week basis to determine:

1. what the transportation demand is;
2. the transportation capacity available to meet demand;
3. if capacity is inadequate, what measures can be taken to correct the situation.

Incorrect/incomplete/inaccurate information will lead to incorrect allocations which in turn will destroy any targets set and render any guarantees useless. Similarly, lack of effective control over the allocation of rail cars, which is translated into orders through the block shipping system, could render guarantees useless. In consideration of these concerns both CP and CN rail recommended that the block shipping system be administered by the central co-ordinating agency. While there was no consensus on this recommendation there were no dissenting comments from any of the participants. This item should be examined in more detail.

iii) Operating Committee

The Operating Committee would be comprised of senior operating officers of the railways and the grain trade and would be chaired by the Co-ordinator of the Central Co-ordinating Agency. As the technical operating arm of the SGTC and CCA this committee would review, and implement those items referred to it by the SGTC and the CCA.

d) Complementary Role of the Canadian Transport Commission and Transport Canada

It is proposed that the Railway Transport Committee of the Canadian Transport Commission would be assigned the following responsibilities by the Central Co-ordinating Agency:

1. It would serve as an arbitrator in matters of dispute between shippers and the railways; and
2. It would carry out major costing reviews as required.

It is proposed that Transport Canada be assigned the following responsibilities:

1. It would administer payment of government funds to the railways;
2. If it was felt that the CCA should not disperse funds based on performance being evaluated by the CCA, Transport Canada could administer the performance and service related bonuses based on decisions of the Central Co-ordinating Agency; and
3. In addition, it would monitor railway investment performance in keeping with the Federal Government's intentions as enunciated in its Policy Statement.

During the course of the consultation process, neither time nor resources permitted the kind of detailed review of railway investment intention needed to satisfy the federal requirements. If the Federal Government has a continuing requirement for railway investment review, particularly as it relates to the western grain network, the department is a logical body to undertake such review and monitoring as is required.

e) Possible Approach to the Negotiation of a Tonnage Guarantee

As noted previously, the two railways have agreed to provide or enter into performance and service guarantees in return for compensation for services undertaken. In addition, it was agreed that a portion of the contribution to constant costs and/or Federal Government payout to the railways could be tied to the performance guarantees.

The performance guarantees would be negotiated by the Central Co-ordinating Agency. Guarantees would be established on a five-year and/or annual basis. The tonnage targets would be set both on a total movement basis (including domestic requirements), and on a port or destination basis. An example would be the 26 million tonne target established by the Canadian Wheat Board for the 1981-82 crop year, but expanded to detail the required movement by port and by railway (i.e. 5.1 million tonnes at Vancouver for CP Rail, 4.9 million tonnes at Vancouver for CN Rail).

From the more general yearly target, quarterly and monthly targets would be established. The Central Co-ordinating Agency would be responsible for monitoring and measuring the actual results against the targets established. The failure to meet the targets would form the basis for determining whether or not a bonus payment would be made to the railways or penalty applied. The factors over which the railways have no control but which inevitably affect performance (strikes and weather) would have to be taken into account in assessing these guarantees.

These negotiated contracts or guarantees would specify the amount per tonne bonus to be paid to the railways for various specified levels of achievement of the target. Payment would be authorized by the Central Co-ordinating Agency and paid by Transport Canada.

For example, we have recommended that the railways be able to "earn" 8% of their contribution to constant costs. This percentage would be held back by the Federal Government and would be payable only upon meeting agreed targets.

If the railways delivered 100% of the guaranteed volume, they would be entitled to the full 8% contribution. This payment would be graduated downwards and the railways would forego any of the bonus if, say, deliveries were less than 90% of the agreed to monthly or quarterly target.

V. (6) Legislative Issues and Implementation

At some point the results of the consultation process together with the recommendations of the Federal Representative will be considered by the Federal Government as the possible basis for legislation relating to grain transportation policy in western Canada. Accordingly, it will be necessary to identify those items and to make whatever observations and recommendations seem necessary and appropriate from the standpoint of the legislative process.

The starting point for any discussion of the legislative issues relating to grain transportation is found in the Federal Government's Policy Statement of February 8, which clearly states that: "a statutory framework should be created by Parliament to give effect to the new arrangements, and specifically to provide a basis on which adequate compensation to the railways for moving grain could be established at the earliest possible date."

Of fundamental importance is the fact that the Federal Government has indicated further that it is prepared "to commit itself by statute to the payment on an annual basis of an amount equivalent to the 1981-82 shortfall in railway compensation."

It is also to be noted that the Federal Government is prepared to consider further statutory commitments relating to:

- a) railway performance and service guarantees; and
- b) ways of ensuring that the level of compensation established from time to time under the new statute adequately protects the interests of producers while providing a fair return to the railways.

The changes which are to take place as a result of the proposals resulting from the consultation process require two general legislative actions:

1. portions of existing legislation that now set the statutory rate, define the products included and prescribe other limiting or enabling factors will have to be repealed or amended; and
2. a new legislative enactment or enactments will be necessary to describe new relationships and commitments, define new duties, identify any changes in items included in the new arrangement, and generally harmonize the new scheme with other federal legislation dealing with transportation, regulatory control, grain and grain products, agricultural marketing and other such issues.

One of the more important questions relating to the legislative framework will be how to provide a certain degree of permanence to the basic concepts and principles which were developed during the consultation process while at the same time permitting the necessary flexibility to accommodate the dynamic and inevitable short run changes in the grain transportation system. To enshrine all the new arrangements in legislation would be to risk a degree of rigidity that would not be productive or acceptable in the long run to either the producers or the railways. If the legislation is too general, on the other hand, all participants in the system will be left with a degree of uncertainty that would be equally unacceptable.

There would appear to be three levels that need to be kept in mind when developing the legislative framework for the grain transportation system:

- a) The need for enabling legislation which includes all those basic concepts and principles which will endure over time and which will provide the fundamental framework for long run policy decisions.
- b) A set of regulations made pursuant to the enabling legislation and which involves the details and substance of the legislation.
- c) A set of specified issues, which cannot appropriately be fitted into legislation or the associated regulations, but which are important and which can be negotiated among certain participants involved in the grain transportation system.

Without attempting to provide an exhaustive list of the topics to be dealt with in the legislative framework, some of the more important items would include: commitment by the Federal Government to the annual payment of an amount equivalent to the 1981-82 railway revenue shortfall, the agricultural adjustment shortfall, railway performance and service guarantees, continued federal financial commitment for branch line rehabilitation, the provision for periodic reviews of certain topics, annual setting of rates, administration of payments to the railways and the producers and the establishment of a Central Co-ordinating Agency with certain duties and responsibilities.

Whether entirely new legislation is provided or whether the route chosen is one of amending existing legislation, it is clear that a number of statutes, regulations and existing organizations will be affected by the proposed new arrangements. No doubt changes will be necessary in the present legislation and regulations relating to the Railway Act, the National Transportation Act, the Canadian Transport Commission, the Canada Grains Act, the Western Grain Stabilization Act, the Canadian Wheat Board Act, and the existing Grain Transportation Authority. Certainly one of the more important aspects of the legislative changes relates to the proposed establishment of the Central Co-ordinating Agency which would have many basic and very important functions and responsibilities assigned to it. In addition the National Transportation Act relating

to the payment of subsidies for the operation of uneconomic branch lines will have to be modified to reflect the increased revenues going to the railways and to ensure that it is consistent with the payment of all or part of the railway revenue shortfall to the railways.

Given the limited time available to the representatives in the consultation process, it was not possible or feasible to provide any detailed analysis or recommendations relating to the amendments required in existing legislation, or particular requirements for new legislation.

The representatives involved in the consultation process did recommend very strongly, however, that a task force led by Transport Canada and including representatives of all the major participants, be established to perform the following functions:

1. Review the draft legislation before it proceeds to Parliament.
2. Review the rate structures arising from the new legislation and arrangements before those rates are published, at least for the first time. (See Section V-4)
3. Analyze in detail the mechanisms and administrative arrangements needed to implement the appropriate payment options.

V. (7) The Review Process

Throughout the consultation process, continual reference was made to the need for a periodic review of the new arrangements including legislation to ensure that the comprehensive approach adopted in 1982-83 was effective and was achieving what it was originally intended to do. Also there are other matters which, due to a lack of time and resources could not be resolved during the consultation process and require resolution in the near future. Some matters were raised which require specialized reviews.

This section is intended to highlight and summarize the various issues identified herein which will require further review and decisions.

- i) Of most significance is the requirement for a periodic costing review to determine and verify the railway cost base for grain transportation operations. In the consultation process, 1980 cost figures updated with inflation indices were used to provide the 1981-82 cost base and the value of the "Crow benefit" which was enshrined in legislation. It should be noted that the freight rates established in each subsequent year build upon the 1980 cost base. It is recommended that a costing study be undertaken in 1985-86 (no later) to provide a new base and to correct for any cumulative forecasting errors that may have occurred in intervening years. The costing review should incorporate any savings resulting from the abandonment of unprotected branch lines.

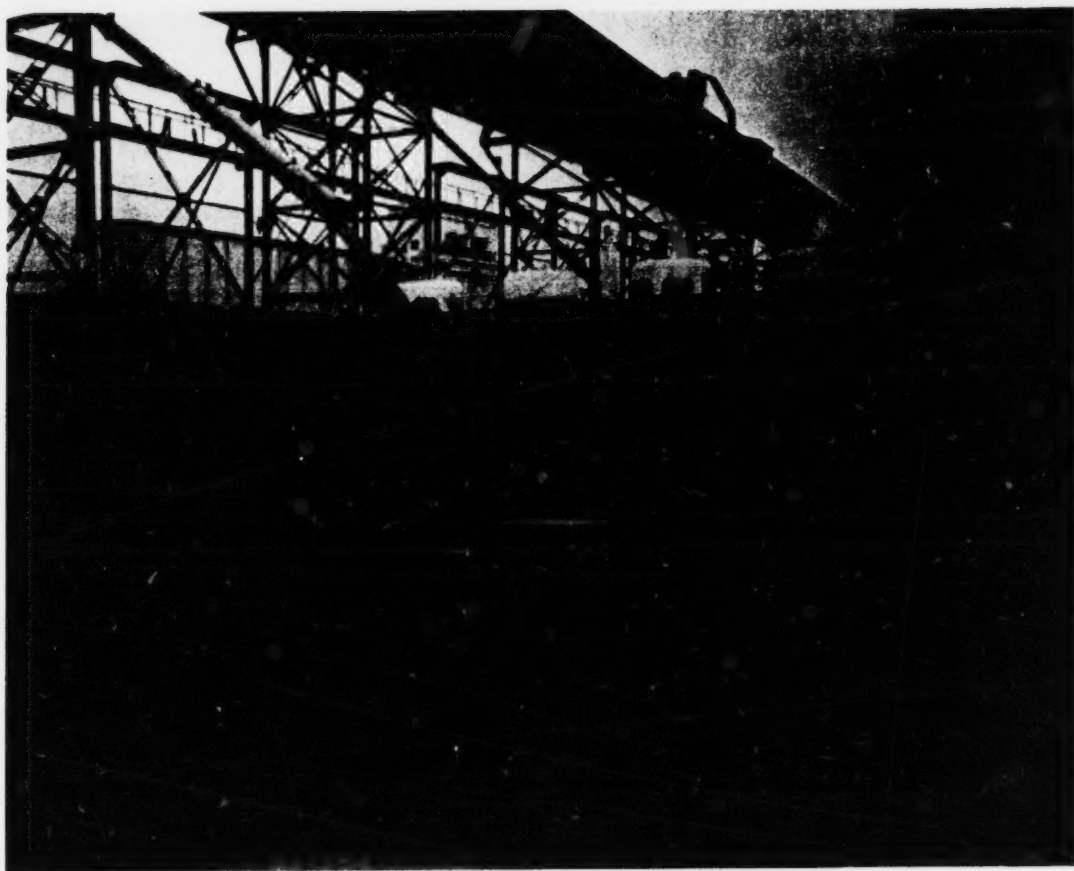
The costing review could include a review of the rate structure to account for any changes in traffic patterns, service levels or operational efficiencies which may have occurred from the original base period.
- ii) It is also recommended that in 1985-86 there be a review of the legislation enacted to bring about the new arrangements as well as a review of the administrative mechanisms established pursuant to those new provisions. Specifically the adequacy of the payment system should be reviewed to ensure that it is meeting the objectives set out (as outlined in Section V (2)).
- iii) In addition to agreeing that the major review should take place in 1985-86, it was agreed that subsequent reviews should occur at least once every five years. Therefore it is recommended that the second major review be scheduled for 1990-91.

- iv) It is recommended that, in 1985-86, the branch line rehabilitation program and the schedule for the succeeding five years be reviewed to ensure that only those branch lines essential for the movement of grain are rehabilitated. It would not be prudent to expend funds on branch lines that are not likely to be a part of the branch line network well into the 21st Century.
- v) While the projected expenditures on the Agricultural Adjustment Fund are scheduled to terminate by 1988-89 it is recommended that a review be undertaken in 1985-86, to ensure that the expected producer adjustments in production and marketing are in fact taking place. While it is anticipated that those adjustments should occur in the projected time frame, practical considerations dictate that provision be made for a one or two year extension if required.
- vi) Certain aspects of the new arrangements will require annual reviews, specifically railway performance and service guarantees. The payment of performance and service bonuses are contingent upon a thorough review of railway performance as described in Section V (5). It is expected that the Transport Canada would administer the performance and service related bonuses based on decisions of the Central Co-ordinating Agency.
- vii) In addition, it is recommended that the hopper car purchase program be reviewed every year to ensure that purchases and additions to the hopper car fleet are consistent with traffic demands and sales.
- viii) It is recommended that the Canadian Transport Commission hearings into the cost of capital for railways decide upon an appropriate cost of capital for grain operations. That cost of capital would be related to the risks involved in transporting grain by an ongoing viable enterprise.
- ix) It is also imperative that the inflation cost indices proposed by the railways be vetted and approved by the CTC by December 31, 1982 prior to legislation being enacted which incorporates the base cost in 1981-82. Producers and their organizations should be allowed input into that process. The railway cost indices should continue to be reviewed regularly by the Canadian Transport Commission.
- x) It is likely that either the Federal Government, the CTC, or the courts will be called upon to finally decide on the CTC ruling on the ownership of rehabilitated assets. If the CTC ruling is overturned, the gross railway revenue shortfall will have to be adjusted to include the cost of capital on those assets.

It is strongly recommended that a complete review of the new legislation, administrative arrangements, and cost base for the railways be undertaken in 1985-86. Such a review is imperative given the significant and substantial changes that are to be made in the legislative, administrative and financial arrangements for grain transportation in western Canada. Adjustments will be required within the industry and it is not unrealistic to expect that adjustments may be required in the arrangements developed and adopted over the next few years. Subsequent five year reviews would ensure a responsive and meaningful comprehensive framework existed and was kept up to date in response to a growing dynamic industry in western Canada.

It would not be in the interests of either the Federal Government, the railways or the producers to allow the legislation and administrative arrangements governing grain transportation in western Canada to fall behind the times once again.





VI. SUMMARY OF RECOMMENDATIONS AND GENERAL OBSERVATIONS

As a result of the consultative process and subsequent analysis, a number of recommendations and general observations relative to the objectives and principles enunciated in the Federal Government's Policy Statement of February 8, 1982, may be made.

Insofar as possible, the recommendations will be categorized and discussed in association with each of the appropriate principles. This section starts with a number of general observations on the results of the overall consultation process.

1) General Observations

In its Policy Statement of February 8, 1982, the Federal Government indicated that the comprehensive approach to grain transportation requires "that all parties make a significant contribution. A fair sharing must be established, taking account of the capacity of each to absorb costs".

In arriving at the recommendations offered, a number of major considerations were recognized in deciding what was a "significant contribution" by each of the parties involved, and what a "fair share" would be "taking account of the capacity of each to absorb costs".

These considerations included the following:

- (1) past and current contributions to rail transportation by the Federal Government, the producers and the railways;
- (2) the undertaking by the Federal Government to make a total commitment of \$3.2 billion for the period 1981-82 to 1985-86 including a commitment to pay annually the railway revenue shortfall established in the base year 1981-82;
- (3) the effect of the current statutory grain rates on special crops, livestock and the agricultural processing industries in the Prairies;
- (4) the need to ensure that the railways are made "whole" at some point while, at the same time, phasing out the special government programs such as the branch line subsidy payments, the branch line rehabilitation program and the purchase of hopper cars;

VI.

- 2 -

- (5) the need for the phasing of certain of the contributions to minimize the disruptive effects of the proposed changes in policy;
- (6) expected increases in future rates of inflation;
- (7) anticipated gains or cost savings resulting from improved productivity and efficiency measures in the grain handling and transportation system;
- (8) the impact of price and income instability in agriculture on the producers' capacity to pay future cost increases;
- (9) the impact of the proposed freight rate changes on the growth and diversification of the agricultural industry in western Canada.

The recommendations were heavily influenced by the results of the consultation process. Where a consensus on any given topic was reached within the consultation process, and if that consensus was consistent with the financial and policy parameters outlined by the Federal Government in its Policy Statement, the conclusions and recommendations were obvious and easy to reach. In those instances where something less than a complete consensus was attained during the consultation process, judgements had to be made in reaching certain recommendations. Wherever feasible and appropriate, the concerns and reservations of the participants were recognized in making these recommendations.

Where fundamental differences remained at the end of the consultation process, every attempt was made to identify the causes for these differences and to outline the basis and the reasons involved in arriving at the pertinent conclusions and recommendations.

We believe that the proposed general approach and the package of recommendations provide the basis for a comprehensive approach to western grain transportation. A basis has been developed for the calculation of the Federal Government's commitment to an annual payment of the railway revenue shortfall. We believe that a fair and reasonable basis has been provided for the determination of the annual contribution to the railways' constant costs. There is a planned phasing towards a time when the railways are fully compensated and when they will be expected to assume those responsibilities and functions now covered by special Government programs. At the same time, there is a planned phasing out of the Federal Government's special programs and projects. A framework has been provided for an increased and reasonable sharing of future transportation costs by the producers. A basis has been developed for the systematic use of productivity gains in the transportation system to reduce overall costs and we believe that the sharing of the savings from productivity gains between the railways and the producers will provide the incentive for continuing savings within the system.

VI.

- 3 -

We believe that a significant contribution and a fair sharing have been established for all the parties concerned. We have recommended that the producers' share of total railway revenue requirements be increased from the present 18.7% to approximately 39% by 1991-92. By 1991-92 the producers would be paying approximately the same proportion of total transportation costs as they did in 1974. In addition, we have recommended that the producers assume the costs of any volume increases beyond 30.4 million tonnes but we do not believe this to be unreasonable in view of the fact that 30.4 million tonnes represent a relatively high initial volume and there may be some years in which this volume will not be reached. If, however, the volume reaches 36 million tonnes by 1991-92, the cost of this additional volume, together with the proposed sharing in the increases in railway costs, would result in the producers' share in total transportation costs rising to 48% by 1991-92.

It must also be pointed out that the producers' contribution towards the increased transportation costs during the period 1982-83 to 1985-86, although appearing relatively modest, would be significant. It is true that they would not begin to participate in any cost increases until 1983-84 and that they would participate in the projected cost increases up to an annual maximum of 3% until 1985-86. However, it should be noted that their cost per tonne would have increased from \$4.89 to \$7.10, an increase of 45% over a three-year period.

The railways, too, will be expected to make a significant contribution towards the cost of a comprehensive approach to grain transportation. They would receive no contribution to their constant costs in 1982-83 and it would not be until 1986-87 that the contribution would rise to 100%. For reasons outlined, we recommend that the contribution to constant costs be set at 20% of volume-related variable costs, somewhat below that advocated by the railways during the consultation process. In addition, it would be only the first 12% which would be incorporated into the rate structure; the remaining 8% would be paid on the basis of performance during the year by the railways. It should also be noted that we have recommended that the total variable costs for the railways be set somewhat below that estimated by the railways themselves. Nevertheless, we believe that the recommendations which we have made will establish the railways as self-sufficient, viable, on-going businesses by 1986-87, and that few, if any, ad hoc and special capital programs will be required of the Federal Government beyond the end of the decade.

VI.

- 4 -

We have also recommended that the Federal Government make a significant contribution to the western grain transportation system. In addition to the \$3.2 billion already committed for the period 1981-82 to 1985-86, we are recommending that it be extended to \$3.5 billion; that the annual payment of the railway revenue shortfall be increased from the estimated initial amount of \$612 million to \$644 million; that the Federal Government participate in a significant way towards the sharing of future cost increases; and that it commit itself to the completion of the branch line rehabilitation program to 1990-91. While the contribution of the Federal Government has been and will continue to be a very significant one insofar as the western grain transportation system is concerned, it is our view that the special programs and ad hoc arrangements of the past decade will have been largely phased out by the end of the 1980's.

We recognize that our recommendations call for a somewhat larger contribution from all parties than each might have originally envisaged. But we believe it to be a fair sharing, taking account of the capacity of each party to absorb costs. We are sensitive to the fact that the capacity of each party to absorb additional costs at the present time is limited. But we are equally sensitive to the cost, the long-run ineffectiveness and the uncertainty associated with the ad hoc and crisis-oriented policies relating to western grain transportation system during the past 10 or 15 years. We realize that those policies were prudent and appropriate at the time. However, as all parties recognize the need for a comprehensive solution, the ad hoc approach must be terminated.

Above all, we believe that the comprehensive approach to the western grain transportation system, although calling for increased contributions from all parties during the next few years, will yield enormous benefits in the longer run; not just to the railways, or producers, or western Canada, but to the nation as a whole.

In reviewing the increased commitment that will be expected of producers in the coming years, we have recommended what we believe to be a fair and balanced sharing. The recommendation goes as far as it can reasonably be expected to given circumstances at this time. We are fully aware of the difficult national economic conditions and the limits necessarily placed on the ability of producers to pay more for all inputs and costs including transportation. Similarly, we are aware of the difficult financial position being faced by the railways and their need for revenues to continue day-to-day operations let alone provide for new investments. We believe the recommendations recognize the limitations currently faced by producers and the difficulties of the railways. The provision for a payment of \$644 million plus per year to the railways, substantially more than they otherwise would have had, should ease their current difficulties.

VI.

- 5 -

One is confident, that agriculture and economic conditions generally will become more buoyant in the years ahead and these changed circumstances and improved conditions will no doubt be reflected when the 1985-86 review is undertaken.

We have developed a framework and a package of recommendations which recognize historic benefits while creating the climate necessary for an efficient and responsive grain handling and transportation system. We believe that the recommendations are pointed in the right direction. Experience during the next few years will indicate whether the details of our recommendations remain valid and relevant. That experience should be brought to bear on the recommended approach during the major review of the system during 1985-86. If further changes are required at that time, we are confident that they can and will be made.

While the recommendations were heavily influenced by the participants in the consultation process - the producers, the railways and the Federal Government - we recognize, in the final analysis, that the recommendations are our own. We anticipate that any remaining differences will receive a full and fair hearing as the next steps are taken to develop the appropriate legislation and implementation plans.

2) Summary of Recommendations

a) Principle 1:

A statutory framework should be created by Parliament to give effect to the new arrangements.

It is recommended accordingly:

That the legislative framework include a commitment by the Federal Government to the annual payment of an amount equivalent to the 1981-82 railway revenue shortfall, the agricultural adjustment shortfall, railway performance and service guarantees, continued Federal financial commitment for branch line rehabilitation, provision for periodic reviews, annual setting of rates, sharing of future cost increases, administration of payments to the railways and the producers and the establishment of a Central Co-ordinating Agency.

That necessary and appropriate changes be made to present legislation and regulations relating to the Railway Act, the National Transportation Act, the Canadian Transport Commission, the Western Grain Stabilization Act, the Canada Grains Act, the Canadian Wheat Board Act and the existing Grain Transportation Authority.

That the Railway Transport Committee of the Canadian Transport Commission serve as arbitrator in matters of dispute between shippers and railways, and carry out major costing reviews as required, consistent with the methodology adopted in this report.

VI.

- 6 -

That Transport Canada administer payment of government funds to the railways, administer performance and service related bonuses, and monitor railway investment performance.

b) Principle 2(a):

The Government of Canada is prepared to commit itself by statute to the payment on an annual basis of an amount equivalent to the 1981-82 shortfall in railway compensation.

It is recommended:

That the 1981-82 shortfall be set at \$644.1 million.

That the Canadian Transport Commission provide a ruling on the cost of capital for the transportation of grain to be applied in calculating the shortfall in railway compensation.

That a task force, including representatives of all the major participants, be established to review the draft legislation before it proceeds to Parliament and to review the rate structure arising from the new legislation before those rates are published, at least for the first time.

That the cost of capital for the transportation of grain be taken as 21% pending a ruling by the Canadian Transport Commission.

That the contribution to constant costs be taken as 20% of volume-related variable costs.

That the railway revenue shortfall payment include no contribution to constant costs in 1982-83, a 25% contribution to constant costs in 1983-84, increasing by 25% each year until 1986-87, when the contribution reaches 100%.

That the Canadian Transport Commission review the procedures for projecting price increases of cost components to establish a base for weighting cost increases for crop year 1983-84.

That an agricultural adjustment shortfall be included in the annual federal payment, designed to offset the loss to the producers of statutory grain for that part of the Crow benefit paid to other grain producers, such payment to commence in 1983-84 and terminate in 1988-89.

VI.

- 7 -

c) Principles 2(b) and 3:

The Government of Canada is prepared to enter into discussions with the producer organizations and railways concerning ways of meeting cost increases incurred in the fiscal years beyond 1981-82. An increased contribution by grain producers will be required.

It is recommended:

That consideration be given to the feasibility of establishing a Grain Freight Rate Stabilization Fund, to be operated by the Western Grain Stabilization Administration, with the provisions that annual levies be collected in a manner and in the same proportion as now in effect for the Western Grain Stabilization Program, and that the funds be used to relate transportation costs to producers to the prevailing price of wheat.

That the cost of transporting future volume increases beyond the 1981-82 base amount of 30.4 million tonnes be borne by the producers of the commodities concerned.

That savings from abandonment of unprotected branch lines and productivity gains from the replacement of box cars with hopper cars be shared equally between the railways and the producers.

That cost increases be shared in a manner outlined in Table V-6B.

- a) for the period 1983-84 to 1985-86, the cost increases be shared equally between the Federal Government and the producers up to a maximum of 3% annual increases for the producers;
- b) for the period after 1985-86, the shippers would pay the first 3 percentage points of cost increases and share equally with the Federal Government the next 3 percentage points of cost increases, with an aggregate maximum increase of 4½% for the producers;
- c) any remaining cost increases be borne by the Federal Government.

d) Principle 4(a):

In return for being compensated, the railways will be required to give performance and service guarantees related to grain transportation.

It is recommended:

That the railways receive the first 12% of the contribution to constant costs as part of the rate structure and that the remaining 8%, plus all line related variable costs, be related to railway performance.

That a Central Co-ordinating Agency, to supercede the present Grain Transportation Authority, be established with the responsibility to administer, with a set of principles and guidelines, the performance and service guarantees to be undertaken by the railways and the efficiency and economy measures to be undertaken in future years.

e) Principle 4(c):

The railways will be required to make adjustments to other rates in order to promote agricultural diversification and processing in western Canada.

It is recommended:

That anomalies relating to the exclusion from statutory rates of canola and linseed meal moving to the west coast, as well as canola oil and linseed oil, be removed by including these products under the new statutory rate structure.

No additional commodities be included under the statutory rate structure.

f) Principles 4(b) and 4(d):

The railways will be required to make commitments regarding additional investment programs that would be undertaken, and presentation of data concerning their revenues, costs and investment plans.

It is recommended:

That the railway investment plans and expenditures in western Canada be monitored to ensure that fair and reasonable levels of investment are being made in the grain railway network, and that increased revenues are not being totally diverted to other system expansions.

g) Principle 5:

The economic distortions within the agricultural sector stemming from the statutory rate should be reduced without recourse to new transportation subsidies.

Two recommendations listed above are designed to reduce these distortions, the inclusion of canola and linseed under the statutory rate structure and the establishment of the Agricultural Adjustment Fund. In addition:

It is recommended:

That the percentage of gross railway revenue shortfall be gradually shifted from payment of the entire amount directly to the railways in 1982-83 to payment of 81% to the producers by 1989-90.

h) Principle 6:

The new framework to be developed should promote increased efficiency and economy in the operation of the grain transportation system and the western railway system as a whole.

It is recommended:

That the Canadian Transport Commission resume and complete its abandonment hearings for unprotected branch lines as soon as possible and that any variations be taken into account in the periodic review of railway costs in the future.

That other potential sources of productivity gains be strongly pursued in the mutual interest of the producers, the railways and the Federal Government.

VI.

- 10 -

i) Principle 7:

Nothing in the new arrangements shall affect the Government's existing financial commitment for branch line rehabilitation and the procurement of additional hopper cars.

It is recommended:

That the branch line rehabilitation program be completed through 1990-91;

That the hopper car purchase program for 1981-82 to 1985-86, recommended by the Grain Transportation Authority, be completed.

That the existing hopper car lease program ending in 2005-06 be continued.

j) Major Subjects for Consultation:

A major subject to be dealt with in the consultations was the manner in which the Government will expend its contributions.

It was recommended under (g) above that the shortfall be paid directly to the railways initially and shifted gradually to the producers and under (a) above that payments to the railways be administered by Transport Canada. In addition:

It is recommended:

That payments to producers be distributed by the Western Grain Stabilization Administration.

That a special implementation task force be established to analyze in detail the mechanisms and administrative arrangements needed to implement producer payment options.

That the individual producer be given a choice of receiving his annual payment in full at the beginning of the crop year or in the form of a freight credit account from which transportation charges on his grain would be deducted, with any remaining balance paid directly to him at the end of the crop year.

That payments associated with rented farm land be made to the tenant.

b) Recommendations for Future Reviews

Given the uncertainties of economic conditions and major changes that may occur therein in even short periods of time and the concerns that may arise regarding the equity and effectiveness of the proposed new arrangements - it is essential that the arrangements be reviewed and that information be updated and appropriate changes be made in accordance therewith within a reasonable time horizon.

It is recommended, therefore:

That in 1985-86, there be a major review of the legislation enacted to bring about the new arrangements and of the administrative mechanisms established to ensure the adequacy of the payment system to meet the objectives and that subsequent reviews be instituted every five years thereafter.

That a costing study be undertaken in 1985-86, and every four years thereafter, to provide new base costs for determination of the rate structure, taking into account changes in traffic patterns, service levels and operational efficiencies which have occurred since the original base period.

That the Agricultural Adjustment Fund program be reviewed in 1985-86 to determine whether a one-or two-year extension is desirable.

That a major review be undertaken in 1985-86 of the continuing appropriateness of the proposed cost-sharing arrangements for 1986-87 and beyond, keeping in mind such considerations as trends in inflation, income and grain prices, adequacy of railway revenue and productivity gains in the system.

That the adequacy and effectiveness of the proposed arrangements for the disbursement of the annual federal contribution relating to the 1981-82 railway revenue shortfall be reviewed in 1985-86.

That the branch line rehabilitation program and the schedule for rehabilitation for the subsequent years be reviewed annually to ensure that only those branch lines essential for the movement of grain are rehabilitated.

That the hopper car purchase program be reviewed every year in light of trends in the volume of grain to be shipped and productivity gains to ensure that additions to the hopper car fleet are consistent with traffic demands.

VI.

- 12 -

That railway performance and levels of service be reviewed annually as a basis for payment of performance and service bonuses related to guarantees required of the railways.

APPENDIX A

GLOSSARY OF TERMS

Following is a list of terms often used in the discussion of grain transportation rates and costs and the most common definitions as they are applied in this report.

1. Variable Costs

Costs incurred as a result of and attributable to the movement of identified blocks of traffic, e.g., fuel, labor, cost of capital, and roadway maintenance.

2. Volume Related Variable Costs

Variable costs whose total increases or decreases in direct proportion with changes in the volume of traffic transported.

3. Line Related Variable Costs

The non-volume related costs of owning and maintaining a railway line whose use is required for the movement of a specific commodity (eg. wheat, coal) or homogeneous group of commodities (eg. statutory grain).

4. Fixed Costs

Costs which ordinarily do not vary with increases or decreases in traffic - e.g., ownership and maintenance of tunnels, bridges, culverts, snow sheds and snow removal, and corporate services such as legal and policy departments.

5. Compensatory Rate

A rate which recovers at least all variable costs, and in most instances makes a contribution to fixed costs.

6. Commercial Rate

A rate which recovers all variable costs, makes a contribution to fixed costs, and normally includes a margin of profit determined by the market place.

7. The Crow Rate

A term embracing the maximum rates the railways have been permitted to charge for the movement in Western Canada of most grain and grain products. The Crowsnest Pass Rate Agreement was signed in 1897.

It has been in force, with one interruption following the First World War, since the end of the 19th century. It is now applied to the shipment of six major raw grains (wheat, oats, barley, rye, flax and rapeseed) and 39 grain products. The rate is about one-half cent per ton per mile or an average of 15 cents per bushel.

8. Crow Gap

The difference between what it costs the railways to move grain and the sum of what the railways receive for moving grain from (a) grain producers and (b) the Government of Canada's branch line subsidy.

9. Crow Benefit

The difference between a reasonable compensatory rate including a contribution of fixed costs and the statutory rate.

10. The Shippers

A group of participants in the consultation process composed of all the producer organizations and the Canola Crushers Association.

11. Statutory Grain and Grain Products

Those grain and grain products which are transported at statutory rates.

APPENDIX B

PARTICIPANTS IN THE CONSULTATION PROCESS

1. Manitoba Farm Bureau

- Co-Op Hail Insurance Company
- Diploma Agricultural Graduates Association
- Federated Co-operatives Ltd.
- Manitoba Branch, Canadian Seed Growers Association
- Manitoba Cattle Producers Association
- Manitoba Chicken Broiler Producers Marketing Board
- Manitoba Egg Producers Marketing Board
- Manitoba Farm Business Association
- Manitoba Hatchery Association
- Manitoba Hog Producers Marketing Board
- Manitoba Milk Producers Association
- Manitoba Pool Elevators
- Manitoba Sugar Beet Producers Association Inc.
- Manitoba Turkey Producers Marketing Board
- Manitoba Women's Institute
- United Grain Growers
- Vegetable Growers Association of Manitoba
- Co-op Implements
- Manitoba Milk Producers Marketing Board

2. Saskatchewan Federation of Agriculture

- Co-Op Hail Insurance Company
- Federated Co-operatives Ltd.
- Saskatchewan Milk Producers Association
- Saskatchewan Municipal Hail Insurance
- Saskatchewan Wheat Pool
- Saskatchewan Women's Institute
- United Grain Growers
- Western Canada Cow-Calf Producers Association
- Saskatchewan Association of Rural Municipalities
- Saskatchewan Chicken Marketing Board
- Saskatchewan Turkey Marketing Board
- Saskatchewan Commercial Egg Producers Marketing Board
- Saskatchewan Hog Marketing Commission
- Dairy Producers Co-operative Ltd.
- Saskatchewan Swine Breeders Association

3. Unifarm

- Alberta Wheat Pool
- United Grain Growers Ltd.
- Alberta Canola Growers Association
- Southern Alberta Sheep Breeders Association
- Western Hog Growers Association
- Alberta Sheep and Wool Commission
- Central Alberta Dairy Pool
- Northern Alberta Dairy Pool
- Alberta Milk Producers Association
- Alberta Broiler Growers Marketing Board
- Lilydale Co-operative Ltd.,
- Alberta Sugar Beet Growers Association
- Alberta Vegetable Marketing Board
- United Farmers of Alberta Co-operative Ltd.
- Pembina U.F.A. Co-operative

(Direct membership: 7200)

4. Prairie Farm Commodity Coalition

(This organization comprises all cattle, hog, poultry and sheep producer organizations in the province as listed):

- Alberta Cattle Feeders Association
- Alberta Dairymens Association
- Western Stock Growers Association
- Alberta Pork Producers Marketing Board
- Western Hog Growers Association
- Canadian Feed Industry Association (Alberta Chapter)
- Alberta Turkey Growers Marketing Board
- Alberta Boiler Growers Marketing Board
- Alberta Egg and Fowl Marketing Board
- Alberta Sheep and Wool Commission
- Western Barley Growers
- Flax Growers Western Canada
- Palliser Wheat Growers Association
- Manitoba Canola Growers Association
- Alberta Cattle Commission
- Manitoba Cattle Producers Association
- Saskatchewan Stock Growers Association
- Central Plains Farm Business Association
- Carmen Farm Business Association
- Alberta Feed Grain Users Association

5. Western Agricultural Conference

- Unifarm
- Saskatchewan Federation of Agriculture
- Manitoba Farm Bureau
- United Grain Growers Limited

6. Canola Crushers of Western Canada

- Albert Food Products
- Canbra Foods Ltd.
- CSP Foods Ltd.
- NARP Processors Ltd.
- United Oilseed Products Ltd.

7. Alberta Wheat Pool

8. Saskatchewan Wheat Pool

9. Manitoba Pool Elevators

REPRESENTATIVES IN THE CONSULTATION PROCESS

<u>ORGANIZATION</u>	<u>REPRESENTED BY</u>	<u>ADVISORS</u>
Manitoba Pool Elevators	Wallace Fraser, President	Greg Arason Bill Strath
Manitoba Farm Bureau	Lorne Parker, President	Bob Douglas Allan Chambers Shelton Fulton
United Grain Growers	Bud Morken, Vice-President	Lorne Hehn Don Fraser A. E. Berry Roy Cusitar
Saskatchewan Wheat Pool	Ted Turner, President	Allan McLeod Jim Wright
Saskatchewan Federation of Agriculture	Hans Seitz, President	Gary Carlson Garfield Stevenson Charlie Phelps
Alberta Wheat Pool	Allan Macpherson, President	Al Beattie Ken Cooksley B. A. Friesen Harry Patching
Western Agricultural Conference	Howard Falkenberg, Chairman	
Unifarm	Gordon Blanchard, Chairman, Transportation Committee	Wilf Plosz Ralph Jespersen

Prairie Farm Commodity
Coalition

Ivan McMillan
Ken Stickland
Chris Mills
Bill Cooper

Stan Price
Richard Davies
Jack Gore
Greg Wholley
Stan Berg
Gordon Reid

Canola Crushers of Western
Canada

John Smythe

Bob Broeska

CN Rail

Ron Lawless,
President

Pierre Casgrain
Stan Hall
Victor Alalouf
Doug Campbell
David Frego

CP Rail

Russ Allison,
Executive Vice-President

John Kelsall
Dennis Apedaile
Frank Wallace
Dave Craig
Bill Somerville
Kevin Conway
Dave Borch

